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Politics this week

May 13th 2004
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America and Iraq

AP

Donald Rumsfeld, America's defence secretary, made a surprise visit to Iraq amid growing controversy about the **abuse of Iraqi prisoners**. Earlier, Antonio Taguba, the American general who compiled a report into the abuse, appeared before a Senate committee and blamed a “failure of leadership” for the misconduct of American soldiers in Iraq. George Bush fended off calls for the resignation of Mr Rumsfeld. Senators emerging from a private viewing of more pictures of prisoner abuse expressed shock at the scenes of cruelty and humiliation depicted. A group of masked Iraqis, claiming to be acting in retaliation, beheaded Nick Berg, an American hostage, and broadcast the gruesome murder on the internet.

See article

In Iraq, peace held in the town of **Fallujah**, where Sunni insurgents have agreed with the Americans to oversee security. An American general hinted that a similar deal might be struck with Shia rebels in the south. American forces launched further attacks on the militia led by Muqtada al-Sadr in Karbala and Najaf.

Israeli soldiers, raiding **Gaza** in search of weapons factories and arms-smuggling tunnels, encountered heavy resistance. Unusually, Palestinian fighters succeeded in destroying two armoured vehicles and killing 11 soldiers, some of whose body parts were paraded through the streets and shown on television. Israel withdrew from Gaza City only after an Egyptian-brokered deal secured its fighters' remains. Around 26 Palestinians were also killed in the fighting.

George Bush tried to dampen **Palestinian** anger following his recent statement that Israel could not be expected to make a “full and complete” return to its pre-1967 borders. He told the Palestinians that he remained committed to the international “road map” and “would not prejudice” negotiations over the two states' “final status”, including borders.

Mr Bush signed an executive order that imposes a swathe of economic sanctions (excluding food and medicine) against **Syria**, as a punishment for its alleged support of terrorism and for trying to undermine American policy in Iraq.

See article

Christian leaders in **Nigeria** said that 500-600 people, most of them Christians, had been killed in two days of rioting by Muslims in the northern city of Kano.

Time for change?

EPA

India's ruling coalition, headed by the BJP, was defeated in an election that has been under way for the past three weeks. The country's best-known reformer, Chandrababu Naidu, was swept from power in state elections in Andra Pradesh.

See article

In the **Philippines**, President Gloria Arroyo was thought to have secured re-election, though the full result will not be known for some weeks.

See article

An arrest warrant for General Wiranto, a candidate in **Indonesia's** presidential election, was issued by a UN-backed tribunal in East Timor.

Change-proof constitution

Germany and **France** want the draft European Union constitution to include a clause that requires amendments to be approved by 20 out of 25 members within two years, according to a German official. The Franco-German proposal was part of ongoing moves to prevent the constitution being blocked altogether if a British referendum rejects it.

The new president of **Macedonia**, Branko Crvenkovski, vowed at his swearing-in ceremony to press on with efforts to achieve reconciliation with the country's ethnic-Albanian minority and avert any resumption of the violence that flared three years ago.

Four new members of the European Union—the **Czech Republic**, **Hungary**, **Poland** and **Slovakia**—pledged to help other ex-communist countries move closer to and eventually join the EU.

Akhmad Kadyrov, **Chechnya's** president and Kremlin ally, was killed in a bomb blast in Grozny, capital of the rebellious republic.

See article

The International Olympic Committee said that after a period of concern it was now confident that the Greek authorities would have all the necessary facilities ready in time for the **Athens Olympics** in August.

Not following orders

Nancy Reagan appealed for an end to America's restrictions on the use of embryonic **stem cells** in medical research. She said the issue, which is enmeshed in the abortion debate, was hindering efforts to tackle diseases such as Alzheimer's (which afflicts her husband, Ronald).

Florida's governor, Jeb Bush, appealed against the latest court decision in the right-to-die case of Terri Schiavo. A judge struck down a law, passed last October, which allows Mr Bush to insist Mrs Schiavo is kept alive through a feeding tube against the wishes of her husband.

A former member of the **Symbionese Liberation Army**, a radical political group, was sentenced to six years in prison. James Kilgore pleaded guilty to his involvement in a 1975 California bank robbery that resulted in the shooting of a female customer. Mr Kilgore was arrested in South Africa where he had been living and working as a respected academic.

Unarmed insurrection

EPA

Venezuela's government arrested some 90 uniformed but unarmed men who, it claimed, were Colombian paramilitaries preparing to overthrow President Hugo Chávez. His opponents said it was a put-up job aimed at disrupting efforts to hold a recall referendum on the president.

See article

Argentina's president, Néstor Kirchner, faced with energy shortages, announced the setting up of a state-controlled energy company and taxes on the export of oil and other liquid fuels.

Cuba's communist government said it would restrict sales and increase prices in the island's "dollar shops". This was a response to a decision by George Bush to curtail visits and cap remittances to Cuba by Cuban-Americans, and to spend more on propaganda against Fidel Castro.

Chile has a divorce law after almost a decade of debate in its Congress. The law, which will come into force in November, allows couples to divorce after up to three years of separation.

Brazil's government ordered a correspondent for the *New York Times* to leave the country after he penned a story alleging that President Luiz Inácio Lula da Silva had a drinking problem.

See article

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Business this week

May 13th 2004
From The Economist print edition

Sky high

Oil prices climbed above $40 a barrel for the first time in 13 years despite Saudi Arabia's call for OPEC to increase production quotas at its meeting next month. Doubts persisted that the Saudi plan would cope with strong demand and fears grew that escalating violence in the Middle East would disrupt supplies. British Airways imposed a surcharge to offset rising fuel costs; other airlines may follow suit.

See article

The EU tried to break the impasse over the Doha round of world trade talks by offering to abolish **farm-export subsidies**, as long as rivals do too. France, the recipient of a large portion of aid worth *euro*2.8 billion ($3.3 billion) a year, called the plan “dangerous”.

See article

Cash from the bank

Citigroup agreed to pay $2.7 billion to settle a class-action lawsuit by WorldCom investors who bought stakes between 1999 and the firm's bankruptcy in 2002, after massive accounting irregularities came to light. WorldCom was highly recommended by Jack Grubman, a telecoms analyst at Citigroup's investment-banking arm.

See article

After five years of deliberation, a committee of international bank regulators approved **Basel 2**, a sweeping overhaul of bank-capital requirements. The new rules are intended to bring about a closer match between the capital held by banks around the world and their risks.

See article

Consolidation among America's banks continued. **SunTrust Banks** of Georgia said it would pay some $7 billion to buy Tennessee's **National Commerce Financial**, thus becoming America's seventh-largest bank by assets.

UBS was fined $100m by America's Federal Reserve to settle charges that it sent dollar bills to Cuba, Libya, Iran and Yugoslavia in violation of American sanctions. The bank, which operates a depot in Switzerland that issues new bank notes and retires old ones, said it would restrict business to Swiss financial institutions in future.

Any udder business?

Hollinger International, owner of the *Daily Telegraph* newspaper, launched a $1.25 billion lawsuit against Lord Black, its former chairman, and other executives. Hollinger accuses Lord Black of using it as a “cash cow to be milked”, alleging fraud and racketeering. Lord Black denies the charges.

See article

Monsanto abandoned plans to market its brand of genetically modified wheat after resistance from American and Canadian farmers who feared the loss of export markets. Environmental groups hailed the decision as a victory. The American biotech giant said it would concentrate on GM soya, corn and cotton instead.

Marks & Spencer lost the services of its chairman, Luc Vandevelde, who was credited with reviving the British retailer. A recent reversal of fortunes led to criticism that he spent too little time dealing with M&S's problems while attending to other business commitments.

Delta Air Lines warned that it would seek Chapter 11 bankruptcy protection unless it could reduce costs and improve competitiveness. America's third-largest carrier is seeking to cut pilots' pay by 30%. So far pilots have offered to take 9% less.

Cisco Systems, the world's leading network-equipment manufacturer, reported that profits were up by 23% in the latest quarter compared with a year ago, to $1.21 billion. Cisco cited an increased range of products and the recovery of corporate IT spending.

Driving away

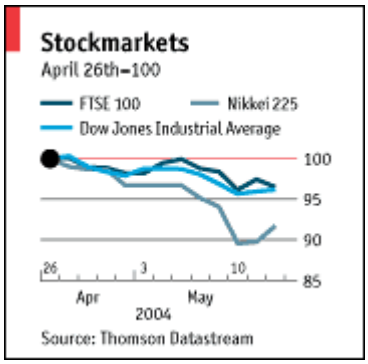
DaimlerChrysler put the brakes on involvement with Asian carmakers. The car giant said that it would end its partnership with South Korea's Hyundai Motor by selling its 10.5% stake in the firm after weeks of rumours that the four-year relationship was over. Last month, Daimler refused to bail out its struggling Japanese partner, Mitsubishi.

Toyota said that profits for the year to March had risen by 55% compared with the year before, to ¥1.2 trillion ($10.6 billion), the biggest ever for a Japanese firm. Toyota sold 6.7m vehicles in the year, second only to General Motors.

Matters of import

America's trade deficit in goods and services grew to a record $45.96 billion in March from a revised $42.12 billion in February. Because of a fast-growing domestic economy, imports grew by 4.6% while exports rose by just 2.6%.

Stockmarkets fell sharply worldwide as concerns grew over oil prices and the prospect of higher interest rates in America. Japan's Nikkei 225 fell by 5% in a day, the Dow Jones Industrial Average slipped below 10,000 for the first time since December and the FTSE 100 suffered its steepest one-day fall in a year.



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The dotcoms come of age

E-commerce takes off

May 13th 2004
From The Economist print edition

Internet commerce is empowering consumers and entrepreneurs alike

Get article background

BACK in 1999, at the height of the internet frenzy, Forrester, a research company, forecast that online retail sales in America could reach $100 billion by 2002. When the bubble burst a year later, lots of crazy predictions went the same way as many dotcom firms. But if online sales of cars, food and travel are added to the official figures, then Forrester's forecast, which once looked so wild, has turned out to be only about a year late. The growth continues. The 200m Americans who now have web access are likely to spend more than $120 billion online this year. And that is only part of the story. E-commerce has not only grown into a huge thing in its own right, it has done so in a way that will change every kind of business, offline as well as online, as our survey explains.

Online, offline—what's the difference?

In America, women now outnumber men online; the average age of all web surfers is increasing; their level of education is decreasing; and their average spending is growing. In short, online consumers are rapidly becoming just like offline consumers. So it should come as no surprise that, just as it was on the high street, clothing was the biggest category of goods sold online in America last Christmas. Similar trends are already evident in Europe and will no doubt spread to Asia.

But e-commerce involves a lot more than retail sales and services such as travel, in which more than half of all bookings are expected to move online within a few years. For instance, billions of dollars of used goods are now sold on internet auction sites, notably on the hugely successful eBay. Second-hand cars are now eBay's biggest category, sales that many once thought would be impossible to conduct on the internet. Some of the big American dotcoms are now finding that growth is accelerating even faster overseas: eBay's Chinese service, for instance, is already the biggest e-commerce site in that country. Then there are the billions spent on everything from pornography to financial services—and this does not include business-to-business (B2B) services, already worth more than $1 trillion a year according to some estimates. Wal-Mart, for one, now conducts all its business with suppliers over a proprietary B2B network.

Consumers clearly love to shop on the internet. So they should: leading websites, after early teething problems, now provide a superb service. Certain sites, such as Amazon, have won some of the highest customer-satisfaction scores ever seen in the retail industry. In fact, websites have had little choice but to raise service levels, often far above those of offline retailers. Competition on the web is fierce. Price transparency is the rule. With shopping-comparison services, it is possible to check the price offered by hundreds of merchants with a couple of mouse clicks. Consumers also have access to an unprecedented amount of product information, not just from manufacturers' websites but also from online reviews written by previous customers.

The growth of internet shopping is producing a profound change in consumer behaviour. People are not just becoming more confident about buying goods and services online, they are also increasingly adept at using the internet to decide where and how to spend their money offline. As yet, very few new cars are sold online. But in America three out of four customers walking into a car showroom have already

researched their choice online, down to what colour and accessories they want. And most will know exactly what they need to pay. Some will even have armed themselves with competing quotes from different dealers, often by using specialist websites. Much the same thing is happening with other goods and services, from domestic appliances to holidays.

No company can any longer afford to ignore the internet, even if it does not itself sell much or anything at all online. Consumers are behaving as if they see no great distinction between online and offline shopping. They do both. For most consumers, the internet is just another sales channel, and a convenient tool for browsing and research, and they make their purchase in whatever way happens to suit them best. To reach these customers, companies have had to look at new and different advertising and marketing strategies. This is why firms are finding that paying for sponsored links to appear on search sites like Google and Yahoo! has become one of the most effective marketing tools, especially for categories of consumers who spend as much time on the internet as they do watching television, such as teenagers.

Safety at speed

The spread of fast, broadband internet connections has been a key factor in fuelling the growth of e-commerce. It has had an even more profound effect on the associated growth of new internet businesses. Already in America and Europe hundreds of thousands of people have used e-commerce services to build new businesses, many of them tiny but lucrative. The internet has shrunk the cost of going into business. For the price of a personal computer, a fast connection and a good website, anyone with an entrepreneurial flair now has the potential to reach customers worldwide. In many rural communities, even in America and Europe, the arrival of broadband has given a big boost to the creation of new jobs. Because of the now-proven benefits of broadband internet access—the empowerment of both consumers and entrepreneurs (sometimes the same people)—governments ought to remove obstacles to the spread of broadband wherever they find them.

The ease of getting on the internet has attracted plenty of rogues. Gartner, another research company, estimates that the use of “phishing”, in which fraudulent emails are used to trick people into parting with credit-card and other personal details, cost American banks and credit-card companies $1.2 billion last year. The software firms, website designers and service providers that have helped build the internet urgently need to make it a safer place to do business. If they can manage to do this, and the spread of broadband can be sustained, the potential of e-commerce is bound to be even greater than in the past few years. A golden opportunity beckons.

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War in Sudan

Don't forget it

May 13th 2004
From The Economist print edition

Outsiders must help to end the latest horrors in Sudan

AFP

LAST week, by acclamation, African countries elected Sudan to serve on the UN's human rights commission: an odd choice, given that Sudan's Arab-dominated regime is currently trying to drive all the black Africans out of Darfur, a region the size of France in the west of the country. In pursuit of this goal, the regime in Khartoum, Sudan's capital, has armed and unleashed a mounted militia that is systematically burning villages and killing or raping their inhabitants. The best-informed observers estimate that 1m people have fled their homes, in addition to the 4m Sudanese already displaced by the country's other, older war (see article).

Sudan's humanitarian crisis may be the world's worst but is neither well-known nor widely understood, partly because the country is so inaccessible but mostly because it is so poor. It won brief notoriety for hosting Osama bin Laden in the early 1990s but he was expelled some time before September 11th, 2001. It is time to put the spotlight on Sudan again—and stop the latest bloodshed.

Confusingly, Sudan is the scene of two separate but related civil wars. One, between north and south, has been flaring up and down for half a century. The other, in Darfur, started only in February last year. The older war pits an Islamist government in the north against southerners who are mostly pagan or Christian. Darfur's conflict is Muslim against Muslim. In any event, the prime source of Sudan's horrors is political. Since independence in 1956, Sudan has been ruled by a small and undemocratic elite of mostly Arab Muslims. In the hope of crushing the long-standing rebellion by infidel southerners, they have routinely bombed villages, encouraged their militiamen to enslave southerners and deliberately fostered famine. Perhaps 2m people, mostly civilians, have died.

The good news is that the war between north and south is nearly over. Under pressure from the United States and others, the government has thrashed out a series of agreements with the main southern rebel group, the Sudan People's Liberation Army (SPLA), which should soon lead to a comprehensive peace deal. The two sides have agreed to share power for six years, after which the south will be allowed a referendum on whether or not to secede.

The bad news is that a lot of people feel left out. The men with guns are about to divide the power (and some petrodollars) between them. In the west and the east of the country, regions utterly neglected by the state, those who feel left out—in particular, in Darfur—have taken up arms. The government has evidently determined to crush them with such ferocity that other Sudanese are too scared to follow suit.

America has for some time threatened that, if the government does not negotiate with the south in good faith, it would impose sanctions on Khartoum and give heaps of cash to the SPLA. But if the regime made peace, it could expect aid, debt relief and a bit of investment. America should now make all this conditional on an immediate end to ethnic cleansing in Darfur and on sincere efforts to negotiate peace in the west as well as the south.

The rest of the world can help too. The UN Security Council should help broker a new ceasefire in Darfur, commit peacekeepers to uphold it, and press the government in Khartoum to address the grievances that sparked the revolt in the first place. Other African states and the African Union, meanwhile, should ostracise Khartoum until it stops ethnic cleansing.

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America and Iraq

Anger and shame

May 13th 2004
From The Economist print edition

There is no easy policy for Iraq, but flight would be the worst of the lot

AP

YOU abuse our prisoners, we saw off the heads of yours—and broadcast the atrocity on the internet, to boot. If it was hard last week to imagine how matters could get any worse, this week has brought a new ration of misery. On Capitol Hill, American officials apologise and squirm in the face of evidence that the maltreatment of Iraqi prisoners at Abu Ghraib was widespread, known about long before it found its way into the public domain, and much more callous—as new pictures and videos are said to show—than has been depicted in the ugly enough photographs published already. From Iraq comes the spectacle of an American civilian, Nick Berg, being beheaded in "retaliation" on video. Not since September 11th has the world felt so close to a collision between what Arabs see as an arrogant, decadent and hypocritical America on one side and what Americans see as an implacable, violent Islam on the other. Did the Iraq war have to end this way?

It did not—and it still need not. The chamber of horrors at Abu Ghraib does not sum up the values of America any more than Mr Berg's murder sums up the values of Islam. Nor was it inevitable, as critics of the Iraq war have taken to arguing, that invading Iraq was bound to lead to the torture of detainees because that is what invading armies always do. As a matter of historical record, they do not always do any such thing. To argue that they do has two perverse consequences. One is to deflect blame from where it belongs—at the top of the chain of command as well as with the individuals who broke the rules. The other is to imply that an America fated to misbehave in Iraq might as well leave right now, before it does even worse damage. Even some of those who favoured the war to overthrow Saddam Hussein have begun to wonder whether a rapid exit might be the least bad of an array of grim options.

To be sure, the harm that Abu Ghraib has done to America's moral authority in Iraq, and to its campaign for the hearts and minds of Muslims farther afield, is incalculable. If a picture is worth a thousand words, these pictures of a cloaked and hooded Iraqi being tormented with the threat of electrocution and of naked ones being taunted by American women, dragged by the neck on a leash or assailed by snarling dogs have without a doubt been worth millions to Osama bin Laden and his henchmen. Some of the damage can be undone by the spectacle of a thorough investigation by Congress and of proper punishment being meted out in courts martial. But it is a matter for profound regret that Donald Rumsfeld, America's defence secretary, has not yet had the grace to make one gesture of contrition that everyone would notice, by submitting his resignation.

America's defenders complain that its soldiers' crimes are nothing compared with those of Saddam Hussein, that far worse abuses occur in Arab countries and that when they do they never result in the same public scrutiny and calls for political accountability. All that is beside the point. Mr Bush's failure to acknowledge the sense of humiliation that Arabs feel in the face of what many Muslims see as America's arrogant determination to impose its own values on the rest of the world has made it vastly harder to do the good that most Americans sincerely and often generously intend.

What next?

At the least, America must now ensure far greater openness, especially in its administration of justice in Iraq. Iraqis must be accorded the same rights under the law as Americans. Outfits such as Human Rights Watch and Amnesty International should be allowed to check prisons. Courts martial of those charged

with committing the abuses that have become notorious through pictures must be shown live on television.

But America and its allies must show strength as well as contrition. Above all, they must not lose heart or nerve. Though Abu Ghraib has made the job far harder, Iraq may still be winnable. Next month's handover to Iraqis, necessarily partial and gradual, must proceed apace. More troops must be sent to help the fledgling Iraqi government. The United Nations must share, with Iraqis and Americans, the political management of Iraq in the dangerous interim between June and the general election in January. The violence is not predestined to worsen, despite the setbacks of the past month. The only certain prescription for disaster is to blunder out in panic, leaving chaos behind. That really would be fatal to the superpower's standing in the Muslim world.

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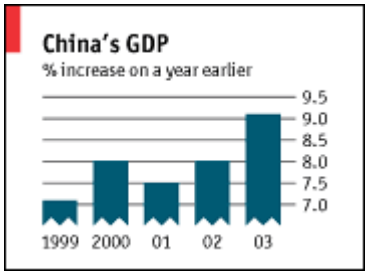
China's economy

The great fall of China?

May 13th 2004
From The Economist print edition

If China's soaring economy has a hard landing, the rest of the world will feel the bump

Get article background



A FASCINATING drama is about to be played out in the world's biggest country. China's economy is growing too fast for comfort, and the country's leaders know it. In recent weeks they have promised forceful measures to cool things down, but it is not clear what they will or can do. Rumours are rife that China's central bank may raise interest rates for the first time in nine years.

The authorities have tried to restrain investment, prices and lending through administrative fiat. The challenge facing them would be difficult for policymakers anywhere: to slow the economy enough to ensure sustainable growth, but not so much as to cause a damaging crash, the much-feared hard landing. But the task of China's policymakers is doubly difficult because they have far fewer tools at their disposal than their counterparts in developed countries (see article). Thousands of state-owned firms, as well as the banking system, do not respond much to pricing signals or interest rates. It is not only 1.2 billion Chinese who should hope that their leaders succeed despite these handicaps. The rest of the world also now has a huge stake in China's continued economic health.

During the past three years China has accounted for one-third of global economic growth (measured at purchasing-power parity), twice as much as America. In the past year, China's official GDP growth rate has surged to 9.7%. Even this may underestimate the true rate, which some economists reckon was as high as 13%.

China's scorching growth has helped to prop up other economies by sucking in imports, which surged by 40% last year alone. While America's industrial output has shrunk over the past three years, China's has increased by almost 50%. As a result, its demand for commodities has skyrocketed, driving up prices. Last year it consumed 40% of the world's output of cement. It also accounted for one-third of the growth in global oil consumption, 90% of the growth in world steel demand, and more than the whole of the increase in copper demand. If China's economy slows sharply, commodity prices will fall everywhere, especially hurting producers in countries such as Russia, Brazil and Australia, which have gained so handsomely from China's boom.

Shocked

The biggest losers from a hard landing in China would be its Asian neighbours. China accounted, on average, for almost half of the total export growth of the other East Asian economies last year. By some estimates, Japan's exports to China and capital spending linked to its export industries accounted for one-third of Japan's total GDP growth last year. Indeed, a slowdown in China would expose the chronic weakness of private consumption in Asia. The recent burst in growth in the region has been much too dependent on exports to China. Although Japan's GDP grew at an annual rate of 4.5% in the second half of 2003, consumer spending rose by only 1%. In South Korea, Hong Kong, Taiwan and Singapore, consumer spending fell slightly, on average, last year.

A slump in China would have a much smaller impact on America and Europe, but some companies would be hurt. Exports to China accounted for about one-fifth of total export growth last year in America and the European Union. However, the biggest risk to these economies lies elsewhere—in the indirect effect of a sharp slowdown in China on financial markets. Another risk lies in the fact that America depends on

China to help finance its budget and current-account deficits. China's purchases of American Treasury bonds, along with purchases by Japan, have helped to hold down yields and hence American mortgage rates. If China's economy continues to overheat, its current-account surplus could soon turn to deficit, and then its central bank would no longer need to buy American Treasuries to hold down its currency.

Fortunately, there are some reasons to hope that avoiding a hard landing in China, despite the difficulties, is possible. This time China's policymakers are stepping in to cool things down earlier than they did in the early 1990s, when inflation was far higher and investment and credit were growing even faster than today. And unlike the East Asian countries which suffered so badly during their economic crisis in the late 1990s, China has a current-account surplus and little foreign debt.

Perhaps the biggest worry for the world economy is the prospect of a “twin tightening” of monetary policy in both China and America. Interest rates of 1% in the United States are dangerously low for an economy with 5% real GDP growth. If America's Federal Reserve is forced to raise rates more rapidly than expected and this happens at about the same time that China's economy slows sharply, stockmarkets would take a beating and global growth could stall. Monetary-policy announcements from Beijing are still not as important as the Delphic words of Alan Greenspan, the Fed's chairman. But as the weight of China's economy in the world continues to grow over coming years, one day they will be.

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India's election

The shine comes off

May 13th 2004
From The Economist print edition

A catastrophe for the ruling party need not spell the end of reform

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AFP

THE results were still coming in as *The Economist* went to press on May 13th, but India's government has suffered a stunning reversal. Even the gloomiest of the exit and opinion polls had envisaged that the ruling coalition, led by the Bharatiya Janata Party (BJP), would lose only a couple of dozen seats, which it was expected easily to make up by wooing a few more small parties into its camp. Nobody expected the Congress party to come out on top—and that goes for Congress's own leadership. Yet this is what has happened. The Congress leader, Sonia Gandhi, relentlessly mocked by the BJP for her Italian origins, could well be the next prime minister of India—though there will be many days of horse-trading to get through first, since Congress is far from being able to form a government on its own, and will need the support of a disparate crew of left-wing and low-caste parties.

The BJP had felt sure of victory. With estimated growth in the year to March 2004 of more than 8%, a seemingly popular leader and greatly improved relations with Pakistan to boast of, its record looked hard to beat: they called it “India Shining”. In the past year or so, after all, India has increasingly been seen abroad as having become a sort of China-in-preparation, poised to embark on the same sort of foreign-investment-led growth that has transformed that other giant.

To many Indians, though, things did not look like that. The exceptional growth in the year just ended, based in part on a favourable monsoon, followed four years of near-drought which has hit rural voters, still the great majority, hard. Peace with Pakistan is all very well, but comes far down the list of priorities for Indian villagers, below more pressing matters such as supplies of clean water and electricity. The probable cause of the BJP's calamity is a simple old-fashioned anti-incumbency vote. To that, though, one must add something else. The religious riots of 2002, in which up to 2,000 Muslims died, took place in a state, Gujarat, governed by the BJP. Although India's Supreme Court castigated Narendra Modi, the BJP's chief minister, for failing to do anything to prevent the massacre, he has never been disciplined, remains senior in the BJP's leadership and was deployed to campaign in the election. Though it projects itself as a modern, reformist party, the BJP's roots lie in Hindu fundamentalism and the worst sort of intolerance. Atal Behari Vajpayee, the BJP leader and prime minister until he resigned on May 13th, may be widely liked, but behind him lurk Mr Modi and his kind.

Is the BJP's defeat a serious setback for economic reform in India? Not necessarily. The BJP has no monopoly on reform: indeed, the party was, historically, a tardy convert to a cause first championed by Congress's late leader, Rajiv Gandhi, and put into practice by the Congress government that took power after his assassination in 1991. The strongest reason to hope that India is indeed on the path to Chinahood is the bipartisan consensus on the virtues of privatisation, deregulation and opening to the outside world.

The problem, though, is that the consensus is bipartisan, not universal. If Congress does form a government it will have to do so with the aid of various left-wing parties, including the Communists of West Bengal and Kerala, which show little enthusiasm for market economics. Still, the BJP grappled successfully with similar problems. And a big part of India's success has come from devolving power to the country's state governments. What happens at the centre is of correspondingly less importance. The main difficulty may arise not so much over reform in general as over India's budget deficit, which is out of control: a left-Congress coalition may find it hard to cut spending. But if reform is likely to slow a bit,

there is unarguably one thing to be happy about, and for which the BJP deserves great credit. Relations between India and Pakistan are better than for many years. Without peace between South Asia's nuclear duo, economic reform would be pretty pointless.

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Letters

May 13th 2004
From The Economist print edition

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Is Rumsfeld responsible?

SIR – The idea that Donald Rumsfeld should be held accountable for the actions of a small group of soldiers is preposterous ("Resign, Rumsfeld", May 8th). There are hundreds of levels of command between the perpetrators of abuses in Iraq and the defence secretary. What is required is not the public gesture of a high-profile resignation but a strict implementation of punishment so that such appalling acts never occur again. Those involved should be subject to court martial and awarded the maximum punishment. Next in line should be the commanding officers who overlooked or were ignorant of what was happening.

Mr Rumsfeld must shoulder some of the blame but he cannot and should not be expected to monitor the behaviour of every soldier in the army. For him to take personal responsibility for these actions is unrealistic and unfair.

Sivarupan Rajendran
London

SIR – As *The Economist* placed its considerable moral and intellectual authority behind the invasion of Iraq, I find your call for Mr Rumsfeld's resignation to be disingenuous. Surely you knew at the outset that this war was led by an American administration with no real plan for a transition to democracy in Iraq, and with little understanding of Iraqi culture, society or politics. To support this war was to support it as it was likely to be fought, not as it ought to have been fought.

Robert Decker
Palm Springs, California

SIR – The Bush administration, through its arrogance and insensitivity has made disastrous errors in dealing with the threat of terrorism. As a result we are stuck with a no-win situation in Iraq, a divided West, and a more radical and unified Muslim world, which will surely produce more recruits for al-Qaeda. It will make little difference if Mr Rumsfeld goes. It is the Bush administration that is the problem. Let us hope enough Americans realise this by the time they vote.

Anton van der Merwe
Oxford

SIR – You call for the resignation of Mr Rumsfeld yet suggest that the American electorate should pass judgment on Mr Bush. You called for Bill Clinton's resignation when the Lewinsky scandal broke. Why the sudden reverence for elections?

Jonathan Aurthur
Santa Monica, California

SIR – The performance of Mr Rumsfeld over the past three years has been imperfect and the scandal of the mistreatment of Iraqi prisoners is horrible but on balance he has served my country well. You in Europe can wail all you want and demand the resignation of whomever you choose. But, until you attain the privilege of voting here, your opinions will remain fundamentally irrelevant.

Patrick Curry
Irvine, California

SIR – Mr Bush's administration downplays the fact that, since time immemorial, torture has been standard operating procedure for military interrogators, despite the lack of evidence that it actually works. If torture was effective, the French would still control Algeria and a land of milk and honey would surround Israeli military prisons.

William Burke
San Francisco

An island divided

SIR – Underlying your balanced article on Cyprus is the Greek-Cypriot belief that there should be one Cypriot state and one people, with some special rights for the Turkish-Cypriot minority ("An ominous European debut", May 1st). In complete opposition is the Turkish-Cypriot belief in their right to self-determination, as recognised by the British government in 1956. In any union with the Greek-Cypriots, they insist on equal partnership.

The UN had tried for decades to reconcile the irreconcilable. Many Greek-Cypriots do not savour living cheek-by-jowl with the Turks in the north, nor do they want to pay for the north's economic development. This should surely prompt the Greek-Cypriots to consider abandoning their deeply questionable claims to sovereignty over the Turkish-Cypriots for satisfaction over territory, property, etc. Freed from crippling embargoes, the Turkish-Cypriots would soon prosper and might well apply for EU membership. Is it not time for the Greek-Cypriot ruling circles to think the unthinkable for the sake of a practical and stable solution?

Clement Dodd
Hemingford Grey, Huntingdon

Succeeding with succession

SIR – You report that Vodafone "had no succession strategy in place when, in December 2002, Sir Christopher Gent...said he would leave" (Face value, April 24th). Putting a groupwide succession plan in place was my first task on joining Vodafone in April 2000. It was completed and agreed by the board in November 2000. Taking over two years for such an exercise would perhaps have resulted in some inadvertent succession planning of my own.

Anthony Gilbert
Global leadership development director
Vodafone Group
Newbury, England

Too many cooks

SIR – Charlemagne briefly touches upon, yet ultimately ignores, the most glaring inefficiency around the EU's table (May 1st). It is not that too many countries are represented, but that too many represent the countries. Ten different configurations of the council, each with around 100 people, make for 1,000 council attendants representing just 25 countries. Surely, a single council with one permanent representative for each country is vastly preferable and better able to defend the interests of member states, even if a future EU has 30 members or more. With more member states around the table, maybe the practice of specialist councils will be a first (and useful) victim of expansion. Sadly, closely followed by some of the finest caterers in Brussels.

Roland Siebelink
Zurich

Uneducated guess

SIR – When reporting on Sunny Varkey's attempts to set up cheaper private schools, you state, "If a private company can provide an excellent education for the same cost at which the government provides a bad one, it undermines a huge assumption about education all over the world" (Face value, May 1st).

The assumption that state schooling is bad is an awfully big one. Given that many countries provide uniformly good state schooling, the question is more about why some British schools are so awful, rather than a grand point about the natural inferiority of the state sector.

William McIlhagga
Bradford

Little green men

SIR – In your article regarding the Sierra Club's elections, you paraphrase Charles Wilkinson as saying "environmentalists should recognise global population growth, whether by immigration or otherwise, as 'the ultimate issue'" ("Rock the vote", April 24th). Surely he did not mean to imply concerns about immigration by extraterrestials.

Marc Sennewald
Houston

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Sudan

Fleeing the horsemen who kill for Khartoum

May 13th 2004 | KHARTOUM, RUMBEK AND TINE
From The Economist print edition

Magnum

Africa's biggest country is in flames

Get article background

HER children's bodies were rotting in the village wells, where Arab militiamen had thrown them to poison the water supply. But Kaltuma Hasala Adan did not flee her home. Leaving her crops and livestock would condemn the rest of the family to death, she reasoned. So she stayed put for four months, despite her government's strenuous efforts to terrorise her into flight.

Her story is typical of western Sudan's black Africans. Her village was first attacked in January. An air raid caught her unawares: as the bombs fell, she ran around in confusion. When the bombers had completed their return pass, the horizon filled with dust, the ground shuddered, and a host of mounted militiamen charged through the village, killing all the young men they could find. During that first attack, Kaltuma's 18-month baby, Ali, was killed by shrapnel. Two weeks later, her oldest son, Issa, 15, was made to kneel in line with other young men before being shot in the back of the head. Her husband disappeared the same day.

For four wretched months, Kaltuma lived with both ears strained for the faint drone of bombers, poised to dash with her three surviving children to a hiding place in a dry river bed. Then the *janjaweed*—an Arab militia that kills for the Sudanese government—rode up to finish the job. They razed her village entirely. She fled from the embers of her hut and trekked for four days through the desert. Across the border in Chad, she found sanctuary in the town of Tiné. Thousands of her neighbours were already there when she arrived.

The UN's humanitarian co-ordinator for Sudan, Mukesh Kapila, described what is going on in Darfur, an arid region of western Sudan, as “the worst humanitarian crisis in the world”. Human Rights Watch, a lobby group, has accused Sudan's Arab-dominated government of crimes against humanity. The government is seeking to purge Darfur of black Africans, using methods as cruel as they are effective. Perhaps a million people have fled their homes. Officials deny ethnic cleansing, of course, but the refugees say they lie.

As Kaltuma tells her story, a crowd gathers to corroborate it. Osman Nurrudin Sadr says his whole family

was killed. Khadija Yacob Abdallah, a pretty 17-year-old, watched her parents die and was then gang-raped. All the refugees offer the same explanation. “They want to kill us because we are black,” says one.

It is a little more complicated than that. Sudan, Africa's largest country, is the scene of two separate but related civil wars. One, between north and south, pits the Arab, Islamist government against rebels who are mostly black African and non-Muslim. This war has been raging intermittently for half a century, but has come tantalisingly close to resolution in the past year: partly because of foreign pressure, especially from America, and partly because both sides, exhausted, wish to stop fighting and share Sudan's new-found oil wealth.

The other war, between the government and two rebel groups in Darfur, pits Muslim against Muslim. The divide in Darfur is ethnic, between Arabs and black Africans. This war flared up only last year. It was seen at first as a mere sideshow, but is now too vast and vile to be ignored.

Centuries of suffering

The south has been marginalised for centuries. Arab slavers used it as a hunting-ground for human booty, despite Anglo-Egyptian attempts to crush the trade in the 19th century. When independence came in 1956, southerners demanded autonomy. They were ignored, so they rebelled.

The war paused between 1972 and 1983, but then resumed. The government used scorched-earth tactics against the main rebel group, the Sudan People's Liberation Army (SPLA), bombing villages suspected of rebel sympathies, and arming and encouraging militias to kill and pillage in rebel-held areas. Slave raids continued, checked only by the absence of tarmac roads in the south.

Largely because it involved Muslims enslaving Christians, the war gripped the imagination of America's influential Christian lobby. In fact, only a minority of southern Sudanese are Christians; the rest are cheerfully polytheistic or animist. Nonetheless, America took an interest, which increased when the radical Islamist regime in Khartoum hosted Osama bin Laden in the early 1990s. In retaliation for al-Qaeda's attacks on American embassies in Kenya and Tanzania in 1998, President Bill Clinton bombed a Sudanese factory he said was producing nerve gas, but which may have been making aspirin. The regime was already distancing itself from its international terrorist associates, a process swiftly accelerated by the American invasions of Afghanistan and Iraq.

Sudan's rulers rounded up terrorist suspects, shared intelligence and froze Mr bin Laden's assets in Sudan, including a cannabis farm worked by child slaves who had apparently been bought from a Ugandan rebel group for one Kalashnikov each.

At the same time, the Sudanese government started to yield to American pressure to seek peace with the south. Negotiations have been tortuous, but Vice-President Ali Osman Taha keeps talking to John Garang, the SPLA leader. If the government shows bad faith, America threatens to choke it with sanctions and to bankroll the SPLA.

Since 2001 the two sides have hammered out a series of agreements that are supposed to culminate in a comprehensive peace. Last September they signed a security accord, mapping out how Khartoum will withdraw most of its troops from the south. This year has seen a written agreement on how to split the revenues from the oil that lies under Sudanese sand, and verbal agreements on power-sharing and the future of three contested areas. Some of these are on the northern side of the line (see map), but their inhabitants consider themselves southern.

For an interim period of six years, Sudan is to remain one country, with Omar al-Bashir, the current president, remaining in office, and with Mr Garang, the rebel leader, as his deputy. Then there is to be a referendum in which southerners will be offered the choice of staying or seceding.

The west burns

The trouble with this plan for a new Sudan is that it involves only the two main belligerents. Peaceful opposition groups have been left out. Since neither the government nor the SPLA is remotely democratic, many Sudanese seethe at the prospect of them divvying up the petrodollars. In Darfur, that rage has sparked mayhem.

Darfur has seen sporadic fighting for generations. As the desert has expanded, camel- and cattle-herding Arab nomads have bickered with black African farmers over dwindling supplies of water and pasture. Darfur's black tribes complain that, since the 1980s, they have been pushed out of government jobs in favour of Arabs. And the region has been flooded with weapons. Khartoum first armed the *janjaweed* so they could ride south and pillage SPLA territory. Arms from a long-running conflict between Chad and Libya seeped across the border into Darfur.

Last year, a new rebel group, the Sudan Liberation Army (SLA) appeared in Darfur and won a string of victories. Soon after, a second group sprang up, the Justice and Equality Movement (JEM). The government in Khartoum felt vulnerable. It was terrified that rebel successes in Darfur might inspire other marginalised groups in the north and east, especially since the SLA has links with a rebel group in the east.

The government struck back, not only against the rebels, but also against their ethnic kin. It unleashed the *janjaweed*. To swell the militia's ranks, Arab criminals were released from jail and given horses, $100 each and carte blanche to loot. (These ex-prisoners are labelled *ta'ibeen,*“those who have repented”.)

The *janjaweed* have clattered into village after African village, torching the straw roofs of conical huts, killing young men who might join the rebels, raping women who might feed them, and stealing everything they can carry off. Sometimes they brand the hands of women they rape, to make the stigma

permanent. They have also torched dozens of mosques and torn up and defecated on copies of the Koran. Whatever inspires them, it is not Islam.

Their victims have no doubt that the *janjaweed* enjoy the state's blessing. When asked what gives them the right to stop blacks at road blocks, the militiamen reply: “We are the government.” When pillaging, they are often supported by the air force and by the regular army. “First the planes come, then the *janjaweed* and finally government soldiers,” says a refugee. “They are brothers united on a mission to kill.”

It was a long time before the outside world took notice. At first, both America and the UN hesitated to make a fuss about Darfur for fear of derailing the north-south peace process. But in March, the UN's man on the spot started making comparisons with the Rwandan genocide of 1994. That was an exaggeration, but it prompted Washington to lean on Khartoum to end the ethnic cleansing. A ceasefire followed on April 8th, supposedly to help aid workers do their job, but was quickly broken.

Fighting and pillage continue, making it hard to feed the displaced. The UN does not want to get too close to the border—the *janjaweed* do not respect international boundaries—so it has moved 35,000 refugees deep into Chad. Tens of thousands remain stranded near the border. Those unfortunate enough to wind up in camps in Darfur have been deliberately starved by the *janjaweed*, according to the UN.

Brave charities such as Médecins Sans Frontières have ignored the occasional air raid to dole out medical supplies, feed the hungriest and vaccinate against a meningitis outbreak. Most refugees in Chad have depended on food and water from the locals who, though poor, are startlingly generous. Supplies are running out, however, and the UN mission is short of cash.

The rainy season is almost here, when the valleys will fill with water and it will be impossible to get the refugees into the half-empty camps that await them. UN lorries lie stranded because there is no money for fuel and the drivers, unpaid for six weeks, have gone on strike.

Over 10,000 newly arrived refugees around Bahai, north of Tiné, have been dismissed as “combatants”—though most are women, children or old men. For the UN, admitting that they are refugees would mean being obliged to look after them. “I'm trying to think of something the UN has done right here, but I'm struggling,” says one aid worker with a sigh.

Spears and ploughshares

There is more to cheer about in southern Sudan. After years of enduring the same abuses now being lavished on Darfur, the south is relatively calm. In Rumbek, the largest town under SPLA control, where abandoned armoured cars rust outside buildings gutted by shelling, hardly any shrapnel has flown for two years.

Half-forgotten tribal traditions are being rediscovered. On a dusty football pitch known as Freedom Square, thousands of young Dinka men, coated with ash and clad in glamorous calfskin skirts, gather to elect a sub-chief. Not long ago such affairs were subdued, forced indoors by the fear of aerial bombardment. Now they are gleefully raucous.

War has left the south shattered. Most of the young warriors queuing behind their chosen candidates have known nothing else. There is no electricity or running water in the south, an area the size of France and Germany combined, and precious few schools, either. Southern children used to join either the rebels or government-backed militias. They grew up knowing how to march long distances on empty stomachs, but not how to read.

Peace, if it lasts, will offer southerners a chance to grow less poor. In one village, your correspondent saw a group of SPLA soldiers melting bullets to fashion spearheads for hunting gazelles. The same men were baffled, however, by a consignment of ploughshares, kindly donated by a western aid agency. Unsure what these strange objects were for, they beat them down to make stools.

Elsewhere, workers can be seen hacking through thorny scrub. They are clearing a path for a road, heading for a large rock in the wilderness known as Ramciel, or “the place where the rhinos meet”. More accurately, it should be “where rhinos used to meet”, as they were poached out of existence some time ago. It is here that the SPLA is thinking of building the south's principal city. Charles Deng, the assistant

foreman, has big dreams for the place. “First we will finish the road,” he says. “Then we will build skyscrapers and ponds, better than London or maybe even as good as Nairobi.”

Not everyone welcomes progress. An SPLA commander in nearby Yirol murmured into his beer that he hoped the capital would be built elsewhere. “If they build it here then they will also build schools and our girls will be sent to those schools,” he said. “You know what that means? Their bride price will fall. My daughters will be worthless to me.”

The end of the war, or of Sudan?

A formal deal ending the war is expected in the next few weeks, possibly sooner. Since President George Bush is widely seen as the architect of peace, he is perhaps more popular in southern Sudan than anywhere else on earth. At the Rumbek sub-chief's election one young warrior called Thuapon leaps frenetically in the air, proudly waving a white Barbie-doll in a pink dress. “This is a new wife for President Bush. May God grant him many fertile women with firm bodies and an election victory without problems in Florida.”

AFP

A new means of ethnic cleansing

The main outstanding issue concerns the religious status of Khartoum. The government wants it to remain under *sharia* (Islamic law); the SPLA does not. Some fudge is surely possible. Observers are confident that a deal will be signed. “If Khartoum were to renege at this point, it would signal that this whole process was a charade from the beginning,” says John Prendergast of the International Crisis Group, a campaigning think-tank.

The difficulty will lie in how the deal is implemented. Unsurprisingly, southerners do not trust the government. “They just want time to re-arm,” says James Thucdong, an aspiring teacher in Rumbek. “We know this is just a peace of one or two years. They will never let us become independent.” Mr Thucdong could well be right. There is no provision yet for what will happen to revenues from Sudan's oilfields, which lie mostly in the south, should voters choose secession.

The two sides are unwilling to discuss this issue, but Khartoum would presumably never let the south go if that meant losing the petrodollars, too. “When preparations begin for the independence referendum, we are going to see major meddling by elements in Khartoum, aimed at creating chaos in the south and delaying [the] plebiscite,” predicts Mr Prendergast.

Another worry is that southerners are squabblesome. During the war, they spent as much time fighting each other as the government. Mr Garang may still be the south's key leader, but his support for a united Sudan will irk secessionists, who are probably a majority in the south. Other ethnic groups resent the politically dominant Dinka people, and even the Dinka are divided.

Once a peace deal is signed, many of the 4m southerners living in squatter camps around the main cities of the north will probably decide to pick their way through minefields and make the long journey home. Tension over scarce natural resources seems likely. As if to confound the optimists, there has been a serious outbreak of fighting in the ancient Shilluk kingdom since March. At least 70,000 people have been driven from their homes after battles between militias loyal to Khartoum and the SPLA. As usual in Sudan, most of the casualties were civilians.

Many voices, many fears

In Khartoum, the mood is apprehensive. The political elite is genuinely alarmed at what capitulation to southern demands might encourage. Says Ghazi Attabani, a former presidential adviser: “If the south were to secede, it would be catastrophic both for Sudan and for Africa. Secession would not be peaceful. Internal differences in the south would cause rifts which would make Rwanda seem like a picnic.”

Because of stringent censorship and the physical difficulty of visiting Sudan's more troubled areas, ordinary northerners have only a rough idea of what is going on in their own country. Some are optimistic. “Of course the people can live together,” says Ahmed Omar Othman, a shopkeeper. “Just look around Khartoum, we do already. Here, you will find a church next to a mosque—surely that [proves it]? The real problem is whether the politicians can work together.”

The record of Sudanese politicians in this area is not good. Their preferred technique for holding this huge and multifarious country together—barbaric force—has been shown not to work. In Darfur, as Mr Attabani admits, “There is no military solution.” Arming gangsters such as the *janjaweed* is easy; reining them in again may prove much harder. Says Sharif Harir, chief negotiator for the SLA rebels: “Even if Khartoum had the will to stop them, it probably doesn't have the power.”

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Terror, torture and the political consequences

A ghastly week

May 13th 2004 | WASHINGTON, DC
From The Economist print edition

Getty Images

Donald Rumsfeld may survive; so may George Bush; but the neo-conservative moment is surely drawing to a close

IT HAS been a week of low ignominy and high drama in Washington, DC. The capital is shell-shocked by the pictures of prisoner abuse, with, ominously, the people who have seen the unreleased pictures from the prison looking the most shell-shocked. The only break from these pictures has come from another depressing image: the gruesome beheading of a Pennsylvania man, Nick Berg, in Iraq.

This being Washington, the city has also been consumed by speculation about the political fallout—and three questions in particular. Will Donald Rumsfeld fall on his sword? Will the Abu Ghraib jail undermine George Bush's chances of a second term? And what are the implications of all this for the wider war on terrorism?

Mr Rumsfeld's fate is the most closely watched. On May 5th, a week after the images from Abu Ghraib were first broadcast, the White House opened the window a crack for a dramatic defenestration. Officials made it clear that Mr Bush had taken Donald Rumsfeld “to the woodshed”, to scold his defence secretary for not alerting him sooner to the photographs and to reports on abuses in the prison. Karl Rove, Mr Bush's electoral strategist, reportedly complained that the president had been “blindsided” by his defence secretary.

But no sooner did the White House open the window than it slammed it shut. On May 8th, Dick Cheney announced that his friend was “the best secretary of defence the United States has ever had”, and warned critics to “get off his case and let him do his job.” Two days later, Mr Bush went to the Pentagon to express his confidence in his “superb” defence secretary. On May 13th, as *The Economist* went to press, the defence secretary, recovering some of his old verve, flew to Iraq, even visiting Abu Ghraib to make his case.

It now looks exceedingly unlikely that the White House will give Mr Rumsfeld the push. Mr Bush, who puts a high premium on loyalty, fired Paul O'Neill only after months of dissatisfaction with his treasury secretary. And Mr Rumsfeld is no Mr O'Neill. He has toppled two hostile regimes and masterminded a dramatic transformation in the armed forces. In the dark days after September 11th he became a national symbol of American resolve. His ties to Mr Bush go back a long way: when Mr Bush first ran (unsuccessfully) for Congress, Mr Rumsfeld was one of the people who bankrolled his campaign.

The administration also worries that defenestrating Mr Rumsfeld would bring more costs than benefits. It would put question-marks next to Mr Bush's judgment in recruiting him in the first place and next to the administration's wider strategy in the war on terror. Nobody is more identified with America's bellicose response than Rummy. The fact that the most vociferous calls for Mr Rumsfeld's resignation are coming from the same politicians who want Mr Bush to return to Texas this November, from the likes of Nancy Pelosi, the Democratic leader in the House, and Senator Teddy Kennedy, has stiffened resolve.

Defenestrating Mr Rumsfeld would also be an administrative nightmare. Lindsey Graham, a Republican member of the Senate Armed Services Committee, noted that removing a defence secretary in the middle of the war "may send the wrong signal to our enemy and empower them". It would throw the Pentagon into turmoil. And who would replace him?

Mr Rumsfeld's neo-conservative second-in-command, Paul Wolfowitz, has even less credibility than his boss does. Going outside the Pentagon would be full of complications. The administration would either have to move a prominent figure from another job or go fishing outside the administration. Senate confirmation hearings would provide a golden opportunity for critics of the Iraq war. And using the dodge of a recess appointment could cripple any new defence secretary.

Yet if Mr Rumsfeld is out of the woodshed, he is not out of the woods. His future depends on the interplay of three things. The first is public opinion. An ABC/*Washington Post* poll showed that seven in ten Americans do not believe that Mr Rumsfeld should be forced to quit, a view held by majorities of Democrats and independents as well as Republicans. But there is far worse to come: videotapes and pictures that may portray rape and even murder.

Major-General Antonio Taguba, the man charged with investigating the abuses, told the Senate that he had found no evidence that the abuse was based on orders from high-ranking officers or involved a deliberate policy of softening up prisoners. The scandal resulted from a "failure of leadership" and the wilful actions of a small group of soldiers.

Alas for Mr Rumsfeld, there is plenty of other evidence that abuse was widespread. A report by the Red Cross that was sent to the Americans in February makes horrific reading: it claims that the abuses against thousands of Iraqis were not isolated incidents, but "systematic", particularly during interrogation. Prisoners were "at high risk" of being subjected to "a variety of harsh treatments, ranging from insults, threats and humiliations to both physical and psychological coercion, which in some cases was tantamount to torture." Other human-rights groups claim to have evidence of prisoners being abused in Afghanistan as well—including two deaths at the Bagram air base.

Mr Rumsfeld's second problem is with congressional Republicans. Mr Graham, a former prosecutor for the air force who looked shattered by the evidence that he has seen, made a point of saying that Mr Rumsfeld's job was not assured—and that a few privates and sergeants should not be allowed to take the fall for what might be a systemic failure. Senator John McCain, whom Mr Kerry mischievously suggested as a replacement defence secretary, said that he would make up his mind about Mr Rumsfeld once he knows who knew what about the prison.

In its gruesome way, the video showing the beheading of Mr Berg allowed Republicans to close ranks behind Mr Rumsfeld as the week wore on. But it will take only a few Republicans to change their minds for him to be forced out. And that still leaves the final factor that will determine his future: Mr Rumsfeld himself.

Mr Rumsfeld's trip to Iraq may turn out to be a tour de force. But the defence secretary looks genuinely stunned by what has happened (and he is not a man who likes to look anything but in charge of the situation). He must realise that he is a badly weakened figure in both Washington and the wider world: a man who seemed a colossus in the immediate aftermath of September 11th, when he famously rushed out of his office to help the wounded in the Pentagon, looks more of a pygmy.

He has little capital left in Washington, let alone the chancelleries of Old Europe. Many of his top generals loathe him almost as much as Colin Powell's people do. Asked to defend his boss at a private dinner this week, one of America's best known generals conspicuously failed to do so. Members of Congress resent him for treating them in such an offhand manner. *A Wall Street Journal*/NBC poll found that just 39% of Americans rate him positively, down from 49% a year ago.

Mr Bush's problem

As for Mr Bush's own job, the growing mess in Mesopotamia continues to claw away at his re-election prospects. A Gallup poll released on May 10th put his job-approval rating at 46% (anything below 50% spells big trouble for an incumbent). Only 37% of people say that they are “satisfied with the way things are going in the United States” against 62% who are “dissatisfied”. Until now Mr Bush's numbers have been kept buoyant by widespread approval of his leadership of the “war on terror”. But the poll suggests that approval may be curdling into hostility: 58% disapprove of the way Mr Bush is handling Iraq and 54% think going into Iraq was a mistake. Mr Bush's lead on the question of terrorism has sunk by ten points.

It is not just the pictures that are exacting a toll. It is the perceived flimflamming over Fallujah—and the growing sense that Mr Bush is up a wadi without a paddle. The polls show that most Americans are willing to tolerate setbacks, from body bags to gruesome photographs, if they think that the leadership is determined to win. But if they aren't confident in victory then they think America should get out.

Mr Bush still has two things on his side. The first remains the hand-over of power on June 30th; even a half-successful transfer could shift America's focus from Iraq (where problems can be blamed on the civilian administration) to domestic affairs, where Mr Bush is beginning to look stronger (see article).

The second is that his support has a very high floor. About 45% of the population will probably vote for him come hell or high water. American conservatives see the Abu Ghraib photographs through a different prism from the rest of the world. They believe that sheriffs in tough towns need tough rules. “I'm probably not the only one up at this table that is more outraged by the outrage than we are by the treatment,” observed Senator James Inhofe of Oklahoma. These prisoners were not there for traffic violations, he said; many of them are terrorists with American blood on their hands. Rush Limbaugh likened the events to a “fraternity prank”.

Conservative America's support for the president was further shored up by the horrific video of Islamic extremists slowly beheading Mr Berg while ranting about the glory of God. Once again, the White House's belligerent response—it has a $10m bounty on the head of his alleged killer—went down well in the heartland.

Farewell, neo-conservatism

Predicting the impact of Abu Ghraib on the election is probably a mug's game. But it definitely marks the end of an extraordinary phase in American foreign policy.

September 11th gave birth to a foreign policy that was characterised by a heady mixture of optimism and moral clarity. The neo-conservatives had been something of minority sect in foreign policy. But after the terrorist attacks, George Bush—and, more crucially, that conservative half of America—firmly endorsed the neo-conservative vision of using American power to bring about a region-wide transformation of one of the world's most backward places. The president also talked about a war of good against evil.

But democratising the Middle East is much easier to talk about in a think-tank beside the Potomac than a prison in Baghdad. The neo-cons have tried to pin the blame for the manifold failures in Iraq on the administration's bungling; even before the current furore, Mr Rumsfeld was widely blamed for not putting enough troops in the country (on that at least, the neo-cons and the generals who despise them as armchair warriors agree).

Yet there is a growing sense on the right that the neo-cons have been revealed as naïve optimists. Pat Buchanan, their traditional enemy, crows that the neo-conservative “hour is up in national politics...As Richard Nixon used to say, ‘they've broken their pick'”. David Keene, chairman of the American Conservative Union, points out that the right is much more receptive to Mr Buchanan's arguments.

It is not just a matter of factional politics at the Bush court. The moral clarity that seemed so important to American foreign policy is beginning to go fuzzy at the edges. Mr Berg's decapitation may have reinforced many Americans' belief that they are, indeed, at war with evil. But the grisly pictures from Abu Ghraib are raising doubts, even in the heartland, about whether American power is an unalloyed force for good in the world.

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The electoral week

On the trail

May 13th 2004
From The Economist print edition

The perfect candidate

“He's too skinny. He should gain weight in all his body, he should gain about 20 pounds. And then he wouldn't need anything.”

Teresa Heinz Kerry denied that her husband has botox injections, but claimed he needed a little work. 20/20, ABC, May 7th

The irony of it

“I feel terrible...It's a mistake. I regret it. I know how important voting is.”

Congresswoman Katherine Harris, Florida's best-known secretary of state, failed to sign her absentee ballot for a local election. Sarasota Herald-Tribune, May 8th

One girl's fun, the world's burden

“At the age of nine I put a Nixon bumper-sticker on the wire basket in the front of my bicycle. Unfortunately the little Catholic girl down the street was a couple years and about 20lbs on me. She was for Kennedy. When she saw me...she put me on the ground, flattened me out and gave me a bloody nose. Despite that beating, I never lost interest in politics.”

Karl Rove to students at Liberty University, Virginia. Associated Press, May 8th

Remember the Alamo

“Democracy is under assault in Texas. Through unconstitutional laws and denial of access to public places, Texas voters are being denied more voices and more choices.”

Ralph Nader failed to qualify for the ballot in Texas; the presidential candidate immediately sued the state to protest its requirement of 64,000 signatures. Washington Times, May 11th

Stealth protest

“I am urging people to volunteer for the Republican National Convention, attend all the volunteer orientation sessions, but not show up for their assigned volunteer shift. Dishonest? Absolutely.”

David Lynn of Shadow Protest on his plan to disrupt the party conventions this summer. New York Daily News, May 10th

Fun Johnny

“Have you had a beer with me yet? I like to have fun as much as the next person, and go out and hack

around and have a good time.”

John Kerry claims he's a fun guy, and you'd better believe it. Associated Press, May 11th

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The Kerry campaign

Edging to the middle

May 13th 2004 | PHOENIX, ARIZONA
From The Economist print edition

Can John Kerry make himself look more moderate?

Reuters

Get article background

THE Phoenix rose from the ashes. Perhaps John Kerry appreciated the reference when he went to Arizona's capital to try, once again, to kickstart his campaign.

For the past few weeks he has been criticised for vagueness, for being merely “not Bush”. He has some excuse for that. Usually, contested primaries force the winner to the left (or right, if Republican); then he has to scramble back in an undignified way to the middle. Mr Kerry shifted to the left on some issues in the primaries (notably his rhetoric on trade); but he mostly managed to avoid this problem because the primaries turned into a victory stroll.

Instead, because there was no contest of ideas, he was left with a new difficulty: he looked like a vague, generic Democrat. Having not really defined where he stood for compared with other Democrats, he has not defined himself against George Bush either—which has allowed the Republicans to do the job for him, depicting him as a liberal flip-flopper.

Mr Kerry has been trying to fight back for some time; last week saw signs he may be making a little headway. First, he took on the teachers' unions by proposing more pay for performance (the unions like the extra pay, but not the strings attached). And at a keynote speech to the annual meeting of the Democratic Leadership Council (DLC) in Phoenix, he insisted that Democrats could be as tough as Republicans by repeating the word “strength” about 50 times in half an hour. He would be strong on national security, strong on the budget and so on.

As a senator Mr Kerry was an odd mixture: he was indeed an arch liberal on social and cultural issues, but he was also a pro-trade fiscal hawk, so he has always had ties to moderate, business-friendly New Democrats. He was one of six Democratic senators to sign their “Hyde Park declaration” in 2000 (updating the New Democrats' founding statement in 1990). Mr Kerry's longstanding interest in new technology and training also dovetails with concerns. The DLC's policy director, Ed Kilgore, helped ghost-write Mr Kerry's campaign book, “A Call to Service”.

Of course, personal ties do not necessarily make Mr Kerry a fully-paid-up New Democrat like Bill Clinton. Still less do they mean he will run convincingly as a moderate (witness his guff on trade), but he is starting to move back to the middle. Bruce Reed, the DLC's president, points out that “we spent years saying Democrats should be strong on national security and take the concerns of the middle class seriously—and here we have a Vietnam vet supporting a middle-class tax cut.” Mr Kilgore adds that Mr Kerry does not, like some former Democratic rivals, implicitly concede national security to Republicans by talking about “their issues” (the war) versus “our issues” (the economy, education).

For Mr Kerry, the label of moderate Democrat is important. More Americans consider themselves conservative than liberal (left-wing), while independent voters lean to the middle. Mr Kerry cannot win the presidency as a second edition of Michael Dukakis, the famously liberal Massachusetts governor who was trounced by George Bush senior in 1988.

Still, turning a Massachusetts liberal into a centrist is hard. Zell Miller, a Democratic senator from Georgia

who supports Mr Bush, said after the DLC meeting that Mr Kerry “is out of touch with mainstream American values”. In Phoenix, Mark Penn, a Democratic pollster, pointed out that Mr Bush is still seen as stronger, more consistent and more likeable than Mr Kerry. And Mr Clinton's former political adviser, Doug Sosnik, argued that public attitudes may harden in the next three months. After that, it will be too late.

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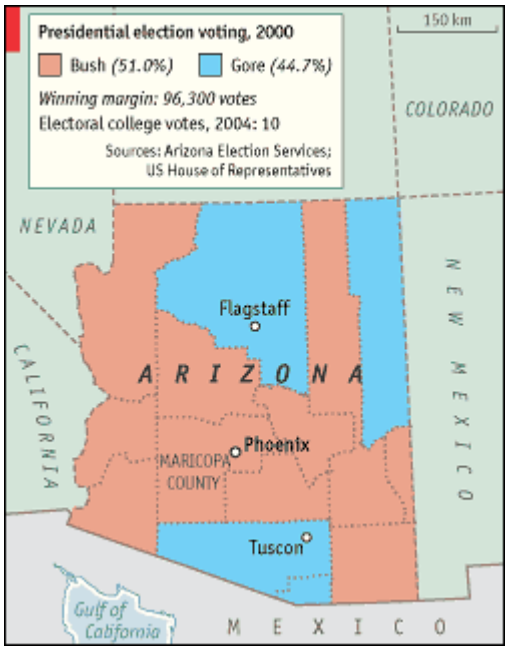
Swing states

Arizona's drift to the left

May 13th 2004 | PHOENIX
From The Economist print edition

The second in our series on swing states ponders how on earth the home of Barry Goldwater became disputed territory



ARIZONA, some experts claim, is the most surprising swing state this year. The stamping ground of Barry Goldwater, the first properly conservative presidential candidate in 1964, voted Republican in every presidential election between 1952 and 1992. Last time round, George Bush won by six points—one of his widest majorities among this year's battleground states.

Yet Mr Bush is vulnerable. In 2002, a moderate Democrat, Janet Napolitano, won the governorship. Democrats have halved the Republicans' advantage in party registration, from 11 percentage points in the 1990s to five now. Arizona contains one of the Republicans' most vulnerable congressional seats, the immense first district, which stretches over the northern half of the state with 640,000 people in an area the size of Illinois. About a quarter of them are Native Americans and if Paul Babbitt, the Democratic challenger, can turn out 20,000 Navajo to vote for him, that alone may be enough to tilt the state for John Kerry. There is also Senator John McCain to contend with: a Republican but no friend of Mr Bush's, he could swing 4% of the vote either way.

The dead-heat between Messrs Bush and Kerry in the polls reflects the same demographic trends that have turned Phoenix into the fifth-largest city in the country, recently surpassing Philadelphia. Maricopa County alone is almost as big as the whole state was in 1990. Arizona is the second-fastest-growing state in America after Nevada. Two in three Arizonans were not born there.

My place in the sun

This is not all the result of immigration from Mexico (though some is: the Hispanic population almost doubled in the 1990s). Rather, it reflects an increase and a shift in migration from other states. In Goldwater's day, the typical new Arizonan was a wealthy Republican voter from the mid-west who had come to retire in the air-conditioned sun and cared about defence and taxes. Now it is a 30-something Democratic-leaner from California, who has come to work and cares about schools, crime, the cost of living and the environment. These are classic swing voters—fiscally conservative, socially liberal.

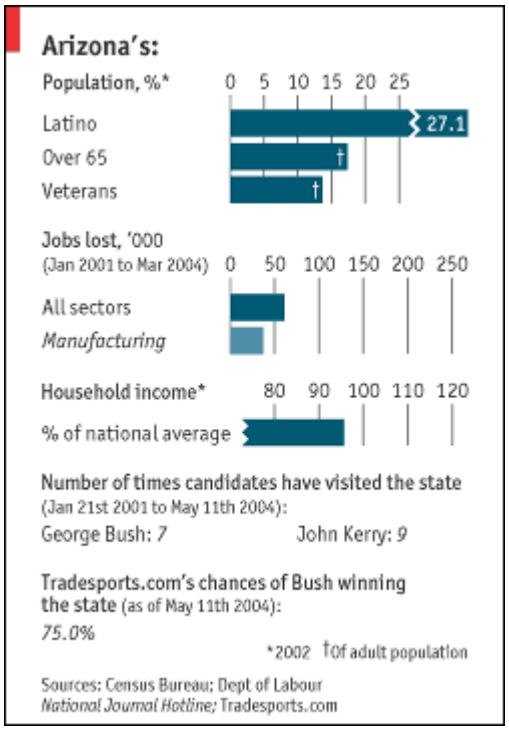
Yet these newcomers explain only part of Arizona's emergence as a swing state; many of them, particularly Latinos, are not diligent voters. The more important explanation lies in the contrasting strengths of the two parties locally.

Until about 2000, the local Democrats were losing members and looked disorganised. But a new local chairman, Jim Pederson, has invested $3m of his own money in state-of-the-art computerised voter files and reorganised the party on approved business-school lines. In the 2002 mid-term elections the Democrats halved the Republicans' advantage in turning out voters. In the past six months, Democrats have added 3,000 names a month to their rolls while Republicans have lost members. Miss Napolitano's chief of staff, Dennis Burke, says Mr Pederson is the best state chairman his party has ever had.

In contrast, Republicans are engaging in fratricide. None of Arizona's top elected officials is much

interested in party building (Mr McCain is more concerned with national politics). Two recent Republican governors have left under clouds. Worst of all, conservative activists have pushed the party to the right just when new voters have moved to the middle. Moderate Republicans, says Earl de Berg, a local pollster, are now starting to break for Mr Kerry.

In most places, being a swing state is synonymous with becoming more centrist. That is partly true in Arizona: Miss Napolitano campaigned and now governs as a moderate. But Arizona's divided status has more to do with populism; this is often far from moderate, but it has untethered voters from parties and from whatever establishment ever existed. The *Arizona Republic* used to be able to make and break politicians. Now it is owned by a national chain and barely tries.



The populist strain goes back to its foundation. The Populist Party was in control then, and wrote into the state constitution provisions for ballot initiatives and voter recalls familiar from California. Goldwater was arguably a populist as much as a conservative (and, for that matter, so is Mr McCain). The populist tendency has been exacerbated since by two factors: the new arrivals, who tend to leave their political affiliation behind them (independents are the fastest-growing political force in state politics), and the fading power of old business elites in Arizona's booming cities.

All swing states are unpredictable, but populist ones lurch more wildly than most. This year, the crucial touch may come from the main instrument of populist politics: there could be a conservative-backed referendum to prevent illegal immigrants and their families from getting state-financed social services and from being allowed to vote. Polls put support at around 70%—though how this plays out in presidential politics is unclear. Mr Bush is much more warmly disposed towards illegals than many local Republicans are.

In California, when Republicans seized on a similar anti-immigrant initiative in 1994, they won handsomely. But it ended up allowing Democrats to paint them as extremists (particularly to Latinos); and the state lurched towards the left. Local Democrats hope that in the long term, Arizona will also become a stronghold for them. But this year it still looks Mr Bush's state to lose.

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Lewis and Clark

"We proceeded on"

May 13th 2004
From The Economist print edition

Why the Lewis and Clark expedition stays in American myth, as well as history

> I set out at 4 O' Clock P.M. in the presence of many of the Neighbouring inhabitents, and proceeded on under a jentle brease up the Missourie to the upper Point of the 1st Island 4 miles...a heavy rain this afternoon.

THUS wrote Captain William Clark on May 14th 1804. He and Captain Meriwether Lewis had spent the winter of 1803-04 at Camp Dubois near the mouth of the Missouri preparing for this day. They had been commissioned by Thomas Jefferson, "that Great Chaructor, the Main Spring" of the expedition, to explore the Louisiana Purchase, the land between the Mississippi and the Rockies. That day, their Corps of Discovery rowed up the muddy current of the Missouri and into history.

Two hundred years later, 25m to 30m people—up to one in seven adult Americans—are expected to retrace part of their journey. Schools are holding special trips. The Mint is issuing coins. The National Council of the Lewis and Clark Bicentennial is running a huge exhibition. Unlike the 500th anniversary of Columbus's voyage, overshadowed by objections from American Indians, the bicentennial of Lewis and Clark will be in proportion to its huge popular appeal.

In 1984 *American Heritage* magazine asked historians which historical event they would most like to have witnessed. Lewis and Clark came second. Stephen Ambrose's triumphalist account of the journey, "Undaunted Courage", remains a bestseller.

Lewis and Clark did not re-shape the known world as did, say, Humboldt (an exact contemporary), Cook or Darwin. For much of the journey, their Corps of Discovery trod Indian trails, followed Indian maps and were led by Indian guides. And they were not even the first whites to traverse North America: Alexander MacKenzie had completed that trip on behalf of Britain's North West Company in 1793.

Jefferson had commissioned them to find a north-west passage—not the sea-route to Asia through the Arctic that Europeans had long been looking for, but a navigable link between American's westward and eastward-flowing rivers. It did not exist. For years, American textbooks made little of their expedition. So what is it about Lewis and Clark that fires America's imagination now?

"It's America's Odyssey story," says Robert Archibald, president of the National Council of the Bicentennial. America's vastness has long given rise to a mythology of journeys, from the Oregon Trail, to Huckleberry Finn "lighting out for the territory", to Route 66 and Jack Kerouac's "On the Road". Like Homer's Odyssey, the Corps of Discovery is America's first and greatest epic.

The 34-strong corps, including an infant and a Newfoundland dog, travelled 8,000 miles, measuring and mapping every step. After chugging upriver through the Great Plains—which caused Clark to wonder that "so magnificent a Senery in a country thus Situated far removed from the Sivilised world [can be] enjoyed by nothing but the Buffalo Elk Deer & Bear in which it abounds and savage Indians"—the expedition wintered in Fort Mandan, North Dakota, surviving on the kindness of Indians who told them that "if we eat, you shall eat, if we starve, you must starve also."

The next year, 1805, they reached the great falls of the Missouri, expecting to drag their goods and boats round it for a day or two. It took 53 days. Saved by amazing coincidence—the wife of a trapper hired at Fort Mandan turned out to be the long-lost sister of the nervous Shoshone leader—they found their most bitter disappointments ahead. On August 12th, Lewis reached the hills where the north-west passage was supposed to be. Instead of the route to the Pacific, "we proceeded on to the top of the dividing ridge from which I discovered immence ranges of high mountains still to the West of us." The hills turned out

to be the Rockies.

In deep snow, they struggled through “those tremendous mountains”, taking twice as long as expected to cross the Lolo Pass and warding off starvation by eating their colts. And so down the salmon-filled Columbia river (though the corps refused to eat fish and bought dogs from Indians along the bank) and the Pacific. “*Ocian in view!* Oh! The joy!” wrote Clark. It was to be the high point of the expedition.

A corps that looked like America

It took them another ten months to trek back to St Louis—and, like Odysseus, the Corps of Discovery returned to a home that had been profoundly changed, partly by their own achievements. The inhabitants lined the bank and fired off guns at the return of a party long given up for dead. Society hostesses gave gala balls at each stop on their way to Washington. They were national heroes. But their popularity now owes as much to contemporary qualities as to historical ones.

The Corps of Discovery looked like America. Captains Lewis and Clark were well-connected southern freemasons. Private John Potts was a new immigrant, born in Germany. The crack-shot, George Drouillard, was half-French, half-Shawnee. The interpreter, Sacagawea, was full Indian. (There are more statues to her than to any other woman in America.) York, Clark's slave, made a bigger impact among Indians than anyone. An incredulous Hidatsa chief rubbed York's skin with his finger to get “the paint” off. Gratifyingly for modern schools, this was not a party of dead white males.

When it reached the Pacific, everyone voted on where to spend the winter of 1805-06, including York and Sacagawea. To many Americans, the vote exemplifies the west's freedom-expanding qualities: only after crossing the Mississippi is true democracy possible.

The group tells America a story that it likes to hear. Early on, all was faction and indiscipline. In August 1804, Private Moses Reed deserted and was tried, flogged and expelled. The men at first refused to obey the orders of Sergeant John Ordway. But *e pluribus unum*. Lewis, Jefferson wrote, was “careful as a father of those committed to his charge”. Eventually, the men willingly followed their captains even when they thought (incorrectly) that the captains were on the wrong river. This transformation was the more remarkable because, breaking every rule of military management, Lewis offered Clark joint command.

The upshot of all this is that the expedition manages not to offend modern sensibilities. The corps was a military expedition, an invading army without the gooey unpleasantness of a real campaign. Only one member died en route—of a burst appendix. The corps shot two Blackfeet Indians, and Lewis draped round the neck of one a medal of friendship that Jefferson had struck. But except for that and a tense meeting with the Teton Sioux, relations with Indians were cordial. It was the first extended entente

between whites and Plains Indians—and the last.

And all the while, the corps was following Jefferson's injunction to record every event in their journals. Ordway wrote down something (often the animals he killed) for each of the 863 days of the trip. The journals run to over 1m words and have recently been given their due in a definitive 13-volume edition by Gary Moulton (University of Nebraska Press). They were, as Clark said “the wrightingest explorers” in history.

But the real significance of the expedition lies in the geopolitics in which it was embrolied. Congress had voted money for the trip four months before the Louisiana Purchase; but the explorers set out after news of the French selling the territory had leaked. The greatest property deal in history, which doubled America's size for 3 cents an acre, thus shaped the context of the expedition.

For the good of democracy

In one way the purchase was a classic piece of Jeffersonian opportunism: Napoleon needed the $15m to help finance his invasion of Britain. But Jefferson had been worried about the west on two scores. First, the so-called “whisky rebellion” of the American states across the Appalachians had shown the danger of “westerners” seceding. It also revealed how reliant the country's trading system was on New Orleans (at the mouth of the Mississippi and Ohio river system), which in turn reinforced Jefferson's desire to find an alternative outlet through a north-west passage.

Second, MacKenzie's trip had made clear Britain's ambitions from the north. In 1802 Jefferson read MacKenzie's account, which concluded by urging Britain to assume control of the Columbia river and the Pacific north-west and create a trading empire stretching across Canada. Lewis took a copy of MacKenzie's book with him on the expedition.

The Louisiana Purchase meant that the Corps of Discovery was no longer just a scientific expedition (though in fact they were the first to describe coyotes, grizzly bears and prairie dogs). They had to pay far more attention to Indian tribes in the north—buffer-states against the British. More important, they found themselves bearing the burden of Jefferson's hopes for the future of American democracy.

Jefferson believed that democracy could best be realised if it were rooted in sturdy yeoman farmers. And he thought the democratic vigour of a growing America could be guaranteed only by more land, which the west could provide. But Jefferson was no fantasist. He wanted commercial ties to bind America's farmers to the world. For him, therefore, the west provided not just the limitless land but (in the north-west passage), the new trading links that the garden of the west would need. No wonder the library at his country estate in Monticello contained so many books about the west. To him, the region was all important. Lewis and Clark became the surveyors of Jeffersonian democracy.

Yet the Corps of Discovery showed Jefferson's vision to be just that—a vision. There was no north-west passage. It would be a long time before farming took over from trapping (and mining) as the west's main business. The Indians did not, as Jefferson hoped, put on trousers, adopt the agricultural revolution and disappear happily into Jefferson's Arcadia; instead they were brutally pushed to one side.

Returning down the Missouri, the corps met several trappers and traders following them upriver. They were the first wave of the white settlers that would overwhelm the Plains. No one—least of all the wretched Indians—could contain America's westward expansion.

The “urge to go west”, to borrow the subtitle of a new book (see article), changed America rapidly. Jefferson thought it would take 1,000 years to settle the west. It took fewer than 100. By 1900, over 15m people lived in the states created along the trail that Lewis and Clark had blazed. The transcontinental railway was completed in 1869 and in 1890 the superintendent of the census declared that a frontier line no longer existed, less than a century after Lewis and Clark had opened it.

Symptomatically, the story ended unhappily for the main participants. Lewis surrendered to despair. He was almost certainly a manic-depressive, though the expedition had halted the course of the disease. It returned with full force when he was appointed to the unwelcome job of governor of the territory of Upper Louisiana. Facing false charges of mismanagement from a political rival, Lewis shot himself in the chest in a hovel. “I fear, O! I fear the weight of his mind has over come him!” wrote Clark. He took 20 hours to die.

York asked for his freedom, which Clark angrily refused, even threatening to sell him to a more brutal master before relenting. As for Clark himself, he lost a bid to be elected governor of Missouri and ended his days as superintendent of Indian affairs at St Louis, negotiating land-concession treaties with the very Indian tribes whom he had befriended years before. And all the while Americans poured west, “proceeding on”.

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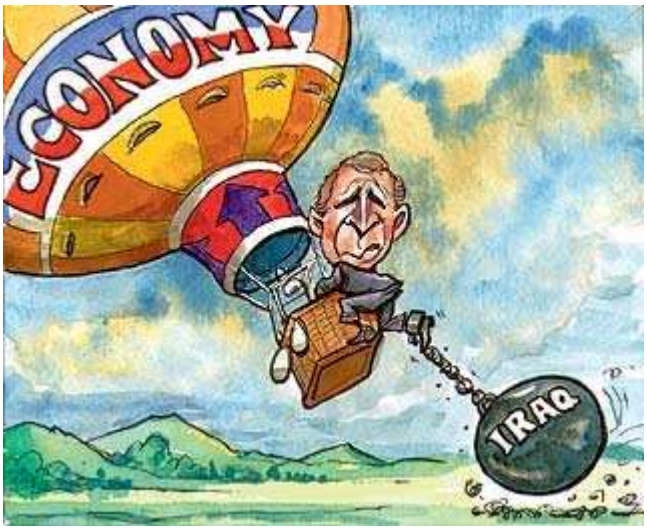
Lexington

At last, a vision at home

May 13th 2004
From The Economist print edition



With things going badly in Iraq, the Bush campaign may stress bold economic ideas at home

Get article background

ECONOMIC policy has long been the neglected step-child in the Bush White House. While the president's attention and his administration's talent have focused on fighting terrorists and remaking Iraq, economics has been reduced to one issue—tax cuts—and left to a second-rate crowd. Both treasury secretaries have been lightweights. Paul O'Neill, the famously gaffe-prone aluminium boss whom George Bush fired in 2002, was an ineffectual policymaker and, by his own admission, outmanoeuvred by Dick Cheney. His successor, John Snow, is a smoother operator but has little heft. While Donald Rumsfeld was revamping the Pentagon and masterminding wars in Afghanistan and Iraq, Mr Snow was ushered forth only to explain away the lacklustre economy and talk about tax cuts.

Now, it seems, the tables are turning. The foreign-policy heavyweights of the administration are sinking in the sands of Iraq and clever neo-conservative theories are no longer in vogue; but the economic plodders suddenly have good news to tell. While Mr Rumsfeld is fighting for his job, Mr Snow can crow that America's economy over the past nine months has grown at its fastest pace in almost two decades. And that growth is finally creating a lot of jobs—288,000 of them in April, far more than expected. The unemployment rate is down to 5.6%, well below its Bush-era peak of 6.3%. Even the beleaguered manufacturing industry, which has shed 2.7m people on Mr Bush's watch, is adding workers now.

This shift in fortunes has a big consequence for the Bush re-election campaign. Conventional wisdom has assumed that Mr Bush would campaign on his record as a war president, the issue where he still enjoys his biggest advantage over John Kerry in the polls, and “play defence” on the economy. Now an aggressive focus on the economy seems ever more likely. Which raises an important question: does the Bush team have a compelling economic vision on which to campaign?

That answer depends on where you look. Listen to Mr Bush himself, or particularly to any of his underwhelming officials, and the message seems simple, narrow and much the same as it has been for the past four years: tax cuts, tax cuts, tax cuts. In the 2000 campaign Mr Bush claimed tax cuts were necessary to stop Congress frittering away the surplus. As the economy faltered, he claimed they were necessary to stimulate it. Now he argues that tax cuts delivered the recovery and must be made permanent (they are due to expire by the end of 2010). Though Mr Bush's stump speeches pay lip-

service to other priorities—such as the need to control health-care costs or curb frivolous lawsuits—they are worryingly one-dimensional.

But talk to the cleverer Republicans around the Bush-Cheney campaign, and it becomes clear that a much more comprehensive agenda exists. It centres on equipping Americans to compete in the global economy by reducing tax, trade, legal and regulatory burdens as well as revamping education and training. The goal is not simply lower taxes, but the eventual elimination of all taxes on investment income. Republicans will use a second term to push an “ownership society” in which people can prepare for their health-care and retirement costs with individual, portable accounts.

Over the next few months, claim these Republican strategists, Mr Bush will flesh out the details of this ambitious economic agenda. Its optimism and focus on the future is intended to differentiate Mr Bush from his Democratic challenger. While Mr Kerry dwells on the problems America faces—the spiralling budget deficit and the jobs lost over the past three years—Mr Bush will paint a glowing picture of the country's economic promise. One current campaign slogan is “Yes, America can”.

There is meat to all this. Instead of shrinking from the thorny subject of reforming Social Security (as Mr Kerry has done), Mr Bush will tout the virtues of private-pension accounts. Instead of fearing global competition, as Mr Kerry appears to, Mr Bush will exhort Americans to embrace it. The president is now deliberately painting himself as an ardent free-trader even in mid-western states hit hard by the loss of manufacturing jobs, while branding Mr Kerry an “economic isolationist”. Over the coming months, the argument goes, he will make similarly stark distinctions between his forward-looking agenda and Mr Kerry's defensiveness across the economic spectrum.

The ownership society

Politically, this strategy has promise—and not just because Mr Bush may need to change the subject from Iraq. Though most voters still disapprove of Mr Bush's handling of the economy and currently favour Mr Kerry on the issue, an optimistic and forward-looking agenda could resonate as the economy continues to strengthen. If jobs are plentiful and house prices strong, Americans may ditch their worries about the deficit, forget their fears of foreign competition and buy into a bigger vision of a confident investor-based society. This was the reforming vision that Mr Bush hinted at in 2000—and it makes a second term a far more intriguing possibility.

But there is a large mathematical caveat. With the deficit already huge, set to reach almost $3 trillion over the next decade, the Republicans' grand plans do not add up. You cannot cut taxes yet further, let alone divert payroll taxes into individual retirement accounts, without inviting a fiscal catastrophe.

Listening to these intriguingly radical ideas, you catch an eerie echo of the boundless optimism that used to characterise Mr Bush's foreign-policy team. Just as the neo-conservative dream of democratising the Middle East had to confront reality in the streets of Baghdad, so the “ownership society” desperately needs someone to pay for it. That part of the equation will not be mentioned very much on the hustings.

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Venezuela's president

Chávez administers the last rites to the rule of law

May 13th 2004 | CARACAS
From The Economist print edition

AFP

The president is close to winning absolute power, making a peaceful solution to Venezuela's political conflict harder

Get article background

A DASTARDLY opposition plot to use Colombian paramilitaries to overthrow the president? Or a government show, designed to discredit a shaky opposition and distract attention from its own manoeuvring to quash a recall referendum? Whatever the truth behind the arrest this week of 90-odd uniformed but unarmed men alleged to be right-wing terrorists at a ranch on the outskirts of Caracas, it spells more trouble for the opposition to Venezuela's president, Hugo Chávez.

Mr Chávez, a populist former army officer, stands on the brink of winning absolute power in his country. The opposition's attempt to invoke the constitution and subject the president to a recall referendum looks doomed. Worse still, a new law enables the president to seize control of the supreme court. And the "paramilitary" incident is the perfect excuse for a crackdown.

"This is a country in which the last vestige of the rule of law has vanished," said Rafael Marín, an opposition legislator, after an attempted raid this week on his house, ordered by a military judge. That is hyperbole—but only just.

After a long filibuster by the opposition was defeated, the National Assembly on April 30th approved a law that adds 12 new justices to the 20-member supreme court. Hitherto, judicial appointments and dismissals have needed approval by a two-thirds majority in the Assembly, which Mr Chávez lacks. Under the new law, likely to take effect this month, only a simple majority is needed. So the president can now both pack and purge the court. Since the supreme court controls the rest of the judiciary, every judge in the land will have to apply the law the way the government wants—or risk losing his or her job.

That is probably the final blow to the referendum. Six months ago, the opposition gathered over 3m signatures for this, well above the 2.4m required by the constitution. But the government-dominated electoral authority disqualified 1.2m of them—requiring those concerned individually to confirm their signature in a laborious exercise due later this month. Even if enough do, the matter is likely to go to the

supreme court. Time is running out. If a referendum is held after August 19th (the mid-point of his term) and Mr Chávez loses, the upshot would not be an election but his vice-president taking over.

The opposition fears that the new law heralds the curtailing of the political liberties that have hitherto prevailed in Mr Chávez's Venezuela. “Those who dare to dissent from the regime will be punished,” says Gerardo Blyde, a constitutional lawyer and opposition congressman. This week, a mayor from his party was jailed on what the opposition says are trumped-up charges. Venezuelans who signed the referendum petition are finding that they may be denied everything from passports to bank loans, government contracts or jobs, and dollars at the cheap official rate.

Mr Chávez retains the support of at least a third of voters. He also controls the armed forces and the all-important oil industry. And with Venezuelan oil at over $30 a barrel, his government is awash with cash. Since Mr Chávez was first elected in 1998, income per head in Venezuela has fallen by 27% (partly because of a two-month general strike in 2002-03). But this year, the economy has started to recover.

So the president looks as if he will easily survive until the end of his term in January 2007, and perhaps longer. The opposition, a mosaic of parties and civic groups, faces an unappetising future. It is held together only by a desire to get rid of Mr Chávez. Absent a referendum, its rickety coalition may fall apart. Moderates may reach an accommodation with the government that allows them to survive—and Mr Chávez to present a façade of democracy. Radical elements, including some former military officers, may try rebellion, armed or otherwise. But the “paramilitary” affair has given the government a pretext to pre-empt any such efforts with a wave of arrests.

Like his mentor, Cuba's Fidel Castro, Mr Chávez thrives on enemies: he sees them not just at home, but in Colombia and the United States. His “microphone diplomacy” has the potential to strain Venezuela's relations with both countries.

A few years ago, the United States might have been expected to make a much more vigorous attempt to stop democracy from being extinguished in a large South American country. But the Bush administration has shown no sign of wanting to do anything that might disrupt the flow of Venezuelan oil ahead of November's election in the United States. So it is likely to confine itself to rhetorical tut-tutting.

Venezuela's relations with Colombia are more complicated. Security along the disputed border is a constant headache; both guerrillas and paramilitaries operate on the Colombian side, and have spilled over. President Álvaro Uribe's government in Bogotá has complained of lack of co-operation from Mr Chávez in dealing with the guerrillas. Venezuela's vice-president this week accused the head of Colombia's army, General Martin Carreño, of involvement with the Caracas “paramilitaries”. General Carreño denied this.

Mr Uribe has held peace talks with the paramilitaries, but these are close to breaking down. It is not wholly implausible that Colombia's paramilitary leaders—and even its army—might make an alliance of convenience with hardline opponents of Mr Chávez. True or not, the president is making it plain that the only role for a democratic opposition in Venezuela is impotence. One day, he may reap the whirlwind he is now sowing.

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Energy in the southern cone

What sort of neighbour is this?

May 13th 2004 | SANTIAGO
From The Economist print edition

Chile suffers from Argentina's energy bungling

Get article background

IN THE late 1970s, Chile and Argentina almost went to war over three small islands off Cape Horn. Since the return of democracy to Argentina in 1983 and to Chile seven years later, relations have been transformed. The border disputes have been settled and the Mercosur trade block has done much to help the two countries link their energy and transport systems. All that has now been placed in jeopardy by the energy policy of Néstor Kirchner, Argentina's president.

Chile has only small deposits of coal, oil and gas. Periodic droughts disrupt hydro-electricity. So it has come to rely on Argentina's cheap and hitherto abundant natural gas for two-fifths of its electricity. Since the mid-1990s, around $5 billion has been invested in cross-border pipelines, gas-fired power plants and the conversion of industries and homes. In March, however, and without consultation, Mr Kirchner ordered a cut of up to a quarter in exports of Argentine gas to Chile, which normally amount to 20m cubic metres per day. The cut was a panicked response to a predictable energy shortage in Argentina, where utility tariffs were slashed by a third in dollar terms and frozen after a devaluation in 2002, but where demand has soared with economic recovery.

What rankles Chile is that an agreement signed by the two countries in 1995 says that Argentina can cut supplies in an emergency—but only in the same proportion as they are restricted at home. “Argentina's deficit is 5%, and a 5% cut in Chile would have been perfectly manageable,” says Rudolf Araneda of GasAtacama, an electricity generator controlled by CMS Energy of the United States and Spain's Endesa. His firm has a 15-year contract for 3.6m cubic meters a day, but is receiving less than a quarter of that.

Chile's government faces local elections in October and hopes to get through the winter without blackouts. So far, the gas cuts have mainly affected the north, home to several big copper mines. Old coal-fired plants there have been brought back into service, and most of the gas-fired plants could switch to diesel. But cuts in gas supplies to central Chile, home to 90% of the population and most (non-mining) industry, would be far more damaging. The central grid has little spare capacity. Avoiding power cuts there may depend on whether winter rains are sufficient to fill hydro-electric dams.

All this comes just when a surge in the copper price has helped Chile to shake off several years of low economic growth. The government is sticking to its forecast of growth of 5% this year. But officials say that using pricier alternatives to gas will cost the electricity industry at least $32m over the next six months. Generators, many of whose customers have fixed-price contracts, will absorb much of that cost. They doubt that they will get compensation for breach of their contracts either from Argentina's government or their suppliers.

Chile's opposition politicians and some businessmen have called on President Ricardo Lagos to retaliate—with trade sanctions or legal action—against Argentina. “We're paying for their energy crisis and they're competing against us with products made with artificially cheap fuel,” moans a local manufacturer. Instead, Jorge Rodríguez, the economy minister, is trying to minimise the cuts, or at least gain a say in how and when they occur.

This week, Mr Kirchner announced measures to boost the domestic supply of energy in Argentina. These include the creation of a new state energy firm, plus taxes on exports of oil and other liquid fuels. But in Chile the cuts have already forced new thinking. Generators say they will insist in future that their

suppliers from Argentina provide greater assurances on supply, use separate pipelines and compensate for cuts.

They will also look further afield. Peru's Camisea field is too distant for fuel to be brought in by pipeline. Bolivia has big reserves but still resents the loss of its coastline to Chile in an unforgotten 19th-century war. It stipulates that “not one molecule” of the gas it will now send to Argentina can be sent on to Chile. So Mr Lagos has launched a plan to build a $500m terminal for imports of liquefied natural gas, to open in 2007.

Mr Lagos has been a loyal ally to Mr Kirchner, lobbying the IMF and the United States on Argentina's behalf. Only days before the cuts came, leaders of his Socialist Party had visited Buenos Aires at the invitation of Mr Kirchner's wife, Senator Cristina Fernández. Chile and its president have every reason to feel aggrieved—and the cause of South American integration has suffered a big setback.

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Dominican Republic

Vote and ride

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Electoral bribes may not save Mejía

DESPERATE times call for desperate measures. Opinion polls show President Hipólito Mejía trailing badly ahead of the May 16th election in which he is seeking a second term as president. So he has resorted to handing out cut-price motorcycles. Some 3,000 have already been delivered in exchange for a small down-payment. The beneficiaries are expected to oblige with their vote. “You know that the hands that give, await,” an aide to Mr Mejía told Dominicans. Another 100,000 motorbikes are said to be on the way should the island's 5m voters keep the president in office.

They are not likely to do so. Mr Mejía, who claims to be a social democrat, has presided over a recession in the tourism and assembly industries. That was not his fault, but much else was. The country suffers continuing electricity shortages, and the government mishandled the collapse of the third-biggest bank last year. This cost the taxpayers $2.4 billion, and featured a wildly generous bail-out for a handful of wealthy depositors. Partly as a result, inflation is running at 10% a month, and the government is seeking to renegotiate some of its debts, now almost 60% of GDP.

Undaunted, Mr Mejía is promising to spend public money as if there were no tomorrow—nor IMF agreement, reached despite palpable qualms at the Fund in February. He has pledged a 30% pay rise for public employees. His previously divided party is rallying round him and he has nudged up in the polls, to 27%. But the favourite is Leonel Fernández, a former president and liberal reformer, standing at 54-59% in the polls. Dominicans remember that the economy grew at 7% a year during his presidency from 1996-2000.

An outright win for Mr Fernández on Sunday would be neater than a result requiring a run-off ballot. Apart from anything else, a close result is likely to prompt accusations of electoral fraud, jeopardising what has so far been a peaceful campaign watched over by foreign observers. A clear mandate would also help Mr Fernández to deal with a Congress which Mr Mejía's party will still dominate until a legislative election in two years' time.

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Peru

Go north, Limeño

May 13th 2004 | LIMA
From The Economist print edition

A middle class amid the shanties

Get article background

The gold in the desert

MEGA PLAZA looks pretty much like any shopping mall, with its smart boutiques, a big department store, a multiplex cinema and a huge gym. Next door stands a second mall, Royal Plaza. What makes these duelling malls unusual is where they are: on a congested and dusty stretch of the Panamerican Highway, in what were once shantytowns and today form part of Lima's northern suburbs.

When it opened two years ago, Mega Plaza defied the notion that Lima's sprawling, largely self-built suburbs are uniformly poor. Between them, the two malls clocked up sales of $130m last year. Their success has sparked a fight between three district councils which lay claim to their site and the tax revenues it can bring.

Nearly two out of three of Lima's 8m people live in three suburban “cones” that stretch out into the barren sandhills of Peru's coastal desert. Some 2.3m live in the northern cone, the oldest-established and most prosperous. “Lima North”, as its five district mayors like to call it, houses the city's biggest discotheque and its most cavernous and crowded supermarkets.

All this is a challenge to much conventional wisdom. To those who claim that Peru's middle class is dying, Rolando Arellano, a market researcher for Mega Plaza, responds that it is being born anew in Lima North, largely overlooked by the city's business and political elites. He reckons that some 20% of the city's middle class now lives in the northern cone. In some of its neighbourhoods, houses with swimming pools are quite common, though others are still makeshift hovels of rush matting.

Officially, one Peruvian in two lives in poverty and income per head is below its level of 1973. Certainly, many Peruvians are poor, and some desperately poor. Yet those figures are hard to credit. There are three reasons to believe that they are wrong. One is drug money, which may account for some of the swimming pools. Another is the informal economy, which is notoriously hard to measure: only one Peruvian in three has a legally registered job. A third is remittances from Peruvians who live abroad: these totalled $1.3 billion last year, according to a study by the Inter-American Development Bank. Whatever the explanation, Peru's future lies in places like Lima North.

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Brazil's president

Clueless, not legless

May 13th 2004 | BRASÍLIA
From The Economist print edition

How to turn an irritant into a disaster

Get article background

Reuters

A social drinker with a revenge

THIS newspaper had planned to use this space to write about efforts to deal with crime in Rio de Janeiro. That changed on May 11th, when Brazil decided to expel an American journalist for offending "the honour of the president", Luiz Inácio Lula da Silva. With that, Lula forced the world's media to pay attention to an embarrassing story that would otherwise have faded away.

The offending journalist, Larry Rohter, the *New York Times* correspondent in Rio de Janeiro, had published two days earlier a story headlined "Brazilian Leader's Tippling Becomes National Concern". In fact, doubts about Lula's grip on government have little to do with rumours about his drinking habits. Opponents as well as allies thought the story unfair. So the president's anger at an "unfounded" report was not surprising. But his response mimicked the way dictatorships dispose of their critics, and turned him from victim to victimiser.

That is sad and ironic. Lula is a former union boss who defied Brazil's military regime of 1964-85, as did many other leaders of his Workers' Party (PT). The last government to expel a journalist was the dictatorship, in 1970.

The expulsion order has caused uproar. It comes at a bad moment. The government has yet to recover from a corruption scandal earlier this year involving an aide. Its fiscal and monetary austerity, designed to lower debt and inflation, is unpopular. Various schemes to help the poor have flopped. This month, the government suffered defeat in Congress, albeit on a largely symbolic vote to ban bingo parlours.

There had been signs that Lula was recovering his grip. For the first time since he took office in January 2003, he organised a get-together of his ten coalition partners. He held a rare press conference to tout his coming trip to China. The government may yet think better of expelling Mr Rohter. But some damage has been done. The expulsion raises more questions about Lula's judgment than anything the journalist wrote.

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India's election

The voters' big surprise

May 13th 2004 | DELHI
From The Economist print edition

EPA

A stunning defeat for the ruling party

Get article background

BAD for the credibility of almost every pundit and pollster; bad for political stability; even perhaps bad for economic reform. But the outcome of India's election has been a triumph for democracy, and the ordinary voter's refusal, after being subjected to months of self-congratulatory government propaganda about “India Shining”, to accept rhetoric over results. As *The Economist* went to press on May 13th, many of the 370m votes cast in the protracted three-week election were still to be counted, and the shape of the new government was yet to emerge from the political fog. But the ruling Bharatiya Janata Party (BJP) had lost. The prime minister, Atal Behari Vajpayee, was on his way to see the president, resignation in hand.

An alliance led by the main opposition party, Congress, seemed likely to have won more than 220 out of the 543 contested seats. The BJP-led coalition, the National Democratic Alliance (NDA), would have about 190. A “Left Front”, dominated by the Communists, had recorded its best-ever performance, and would have about 60 seats. Since the Left's main priority is to oust the BJP, a coalition grouped around Congress seemed the most likely new government. Congress's leader, Sonia Gandhi, the Italian-born widow of a former prime minister, has been scorned by the BJP for her foreign origins and political cackhandedness. She has, however, had the last laugh. Her party has increased its number of seats from 112 to nearly 150—a number beyond its dreams even a month ago, and probably a few seats more than the BJP won. She is now first in line for a chance to become prime minister.

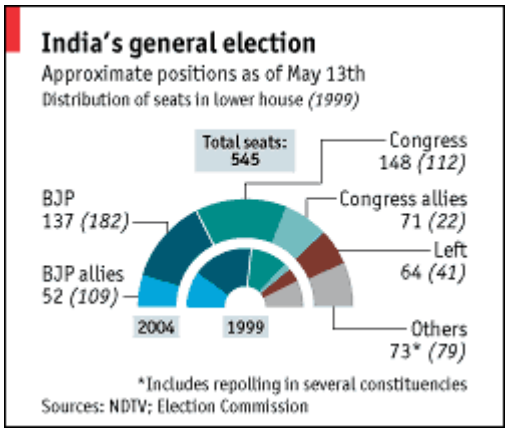
The prospect of a period of political jockeying and potential instability will worry investors, who also fear that the election will be taken as a popular rejection of the liberalising reforms of the Indian economy, recently championed by the BJP. In two state-assembly elections held simultaneously, well-known reformist leaders have been ousted.

Chandrababu Naidu, the chief minister of Andhra Pradesh, was a darling of development banks and the press for his commitment to fiscal discipline, social reform in the countryside, and, above all, information technology and e-government. He helped turn the state capital, Hyderabad, into one of India's IT hubs, but was swept out of power in a landslide. Congress's S.M. Krishna, chief minister of neighbouring Karnataka, where the software boom has not spread its benefits far beyond the capital, Bangalore, also lost and quit—so this is not just party politics.

Such is the strength in India of the “anti-incumbency” vote that Karnataka is in fact one of the few states where the BJP has fared well. One of its few consolations is to have established this foothold in the south, and to advance progress towards its goal of becoming, like Congress, a truly national party. A lavish monsoon last year was an important contributor to India's soaring rate of economic growth, of more than 8% this year, and to what the BJP misdiagnosed as a national “feel-good factor”. But Andhra Pradesh and Karnataka suffered yet another year of drought. There, the shortage of water mattered far more to most voters than the latest call-centre.

Similar considerations, on a national level, weighed against the BJP itself. It has lost more than 40 of its 182 seats. Encouraged by a good showing in state elections last December, BJP strategists had persuaded Mr Vajpayee to call elections a few months early. They argued that the BJP should capitalise on the economic boom, and on the unrivalled prestige enjoyed by the prime minister himself.

His drive to build a lasting peace with Pakistan was hugely popular; but it has weighed little with voters. Indeed, the entire “India Shining” campaign had little resonance for the two out of three of India's 670m voters who live in the countryside, and remember the bad years that preceded the last, abundant monsoon. Their disillusionment was reflected in what was by Indian standards a low turn-out of around 55%. Their villages have seen little improvement in roads, electricity and water supply. A quarter of India's people still live in severe poverty.



The BJP's boosterish rhetoric backfired, and towards the end of its campaign was jettisoned in favour of a stress on the virtues of continuity and stability.

Before the vote, the NDA lost some important members, and others have fared badly, notably the BJP's biggest ally, Mr Naidu's Telugu Desam Party (TDP) whose 29 seats in parliament have dwindled to just a handful. Another disaster hit the NDA in the southern state of Tamil Nadu, where its former member, the Dravida Munnetra Kazhagam (DMK), routed the BJP's coalition partner.

Drawn and quartered

Congress, for its part, traditionally too proud for grubby coalition politics, had this time assembled an impressive haul of allies. But parliament will be hung, and to form a government it will still need the support of the left, and perhaps of one or two other uncommitted parties, of which the biggest are Samajwadi and the Bahujan Samaj, two lower-caste based parties with their strength in India's largest state, Uttar Pradesh. Some of these potential partners may balk at supporting Mrs Gandhi as prime minister. One rumoured alternative from within Congress is Manmohan Singh, a respected former finance minister.

An unstable coalition government, relying on the support of the Communists, is unlikely to prove radical, and may be short-lived. But the presence of Mr Singh in Congress—as a senior policymaker, at any rate, if not in the top job—is one reason for guarded optimism that the election result will not mean the stalling of economic reform. It was Mr Singh who launched the opening up and liberalisation of the economy in 1991. Congress's manifesto commits it to a policy of sustaining and even accelerating current rates of economic growth. That will not be possible without more reform: cutting the fiscal deficit; continuing to foster competition; privatising more state-run enterprises.

There are other reasons for cheer. First, one of Mr Vajpayee's dreams commands consensus support and will surely still be followed: building a lasting peace with Pakistan, a project dear to Congress the last time it was in power. Second, the electoral rebuke for the BJP from rural India might intensify efforts to spread some of the alleged shine to the gloomier parts of the countryside. Properly interpreted, it should not thwart reform, but spur it.

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The Philippines' election

Presidential capers

May 13th 2004 | MANILA
From The Economist print edition

Gloria Arroyo looks to have won—but it may take a month to be sure

Get article background

THERE is no business so much like show-business as an election in the Philippines. When Filipinos went to the polls on May 10th, there was plenty of razzle-dazzle in the form of Fernando Poe junior, a matinee idol and presidential candidate whose campaign mainly seemed to rely on a dancing-troupe called the Sex Bombs, as well as various actors, comedians, newscasters and sportsmen competing for lesser posts. There was comedy, thanks to the would-be vice-mayor who crowned his final rally by cutting off his little finger, and tragedy, as the campaign claimed 115 lives in assassinations, bombings and brawls. The head of the election commission collapsed dramatically two days before the vote, after the Supreme Court threw out his plans for a quick count to complement the slow official one.

AFP

FPJ's only assets

That now means weeks of suspense about the results, although exit polls show Gloria Arroyo, the incumbent, leading the race for the presidency. In the meantime, Mr Poe's supporters insist he will pull off a surprise ending worthy of one his films—unless Mrs Arroyo rigs the vote.

At first glance, it is surprising that Mrs Arroyo is in the running at all, let alone in the lead. After all, Joseph Estrada, another movie star, won the last presidential election by a landslide. After protests against corruption forced him from office—allowing Mrs Arroyo, the vice-president, to take over—he bullied his friend Mr Poe into running as a sort of avenging understudy. Mr Poe, universally known as FPJ, is even more popular than Mr Estrada. His nickname is “Da King”, and he is to Filipino cinema what Elvis Presley once was to American music: far and away the most celebrated figure in the business.

But for all his showbiz credentials, Mr Poe has run a lacklustre campaign. Unlike Mr Estrada, who served as a mayor, senator and vice-president before his presidential bid, Mr Poe, a high-school drop-out, had never run for office before. He was tight-lipped and irritable on the stump: so much so that several journalists covering his campaign mounted a brief boycott. He refused to debate with Mrs Arroyo, or to describe his policies in any detail, reinforcing the impression that he was simply a surrogate for Mr Estrada and the circle of Ferdinand Marcos, a former dictator, a witness at Mr Poe's wedding. Indeed, Mr Poe took time off to lay a wreath at the feet of Marcos's embalmed body, in the presence of Imelda, Marcos's well-shod widow.

Mrs Arroyo, on the other hand, is a seasoned campaigner. She won her past bids for senator and vice-

president (elected separately from the president) by record margins. Her elevation to the presidency during Mr Estrada's term allowed her to run as an incumbent—a unique advantage, since the constitution normally limits presidents to a single term, and one that she exploited to the full. The first task of any public-works crew, it seems, is to put up a billboard identifying the project they are working on as a priority of the president. Her picture even appears on the cards entitling Filipinos to free health care.

Mrs Arroyo also out-manoeuvred Mr Poe in the race for endorsements. Several churches with memberships of millions backed her, as did various regional barons who used to support Mr Estrada. She had allies running for every one of the 17,000 jobs on offer, from the national Congress to municipal councils. Mr Poe signed up only 12,000.

These local cohorts do not just campaign for national candidates. They also muster voters on election day, and try to ensure they plump for the right candidates, by both fair means and foul. All Filipinos assume that a certain amount of *dagdag-bawas*, meaning addition and subtraction, goes on during the count. Analysts even distinguish between retail cheating, when local officials sneak in an extra vote or two at the precinct level, and the wholesale kind, when the numbers are doctored during the amalgamation of the results in the municipalities or provinces.

That is the sort of thing Mr Poe is complaining about, along with intimidation of voters, tampering with the electoral rolls and abuse of public funds. But Guillermo Luz, of Namfrel, an election-monitoring NGO that has exposed fraud in the past, says that the group's 300,000 volunteers have noticed nothing more sinister than the usual bureaucratic bungling.

While Mr Poe's complaints are unlikely to overturn the result, if Mrs Arroyo has indeed won, they do hint at the sort of distractions that might destabilise the next government. Mrs Arroyo has pledged to reduce the country's huge public debt, speed up growth, improve the tax take and produce constitutional reforms to make the Philippines more governable. But she will have to put all these proposals past the same obstreperous politicians who stymied her previous administration. The stage is set for a dramatic sequel.

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Japan

Kan pays late

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From The Economist print edition

A scandal derails the opposition two months before elections

AP

Now Kan can't

ONLY six months ago, the beaming smile of Naoto Kan symbolised a historic achievement for Japan's opposition. Mr Kan's Democratic Party of Japan (DPJ) had just put up an impressive fight in a general election against the Liberal Democratic Party (LDP), which had dominated politics almost continuously since 1955. Although the DPJ failed to win a majority, the close election seemed to usher in a long-awaited era of competitive two-party politics, something Japan has never enjoyed but sorely needs. The DPJ looked far less competitive on May 10th, however, as a chastened Mr Kan resigned in embarrassment after being outflanked by Junichiro Koizumi's government over a pensions scandal. The DPJ fell quickly into disarray, which is no place to be with upper-house elections looming in mid-July.

Mr Kan's original transgression was unremarkable: he failed to pay premiums into the national pension plan during a ten-month stretch in the mid-1990s. Many other political heavyweights, including six members of Mr Koizumi's cabinet, committed similar misdeeds. Mr Kan would probably still be leading the DPJ, therefore, if he had not committed a second, unforgivable, political sin: hurling accusations at his enemies before taking the elementary precaution of confirming that his own record was clean. To spice up the debate over a pensions-reform package, Mr Kan had been attacking non-payers in the Koizumi cabinet before news broke that he, too, had missed payments. When the government's top-ranking pensions offender—the chief cabinet secretary, Yasuo Fukuda—then resigned to take responsibility for his co-partisans, Mr Kan was left with little option but to fall on his own sword in response.

This week the DPJ scrambled to find a successor to Mr Kan. The party's leading lights offered the job to Ichiro Ozawa, who folded his Liberal Party into the DPJ before last year's elections. Mr Ozawa said he would “seriously consider” the invitation. But the succession issue raises tricky questions for the DPJ—and not just because the peripatetic Mr Ozawa has made a career of tearing political parties asunder. Former Liberals want to loosen restrictions on Japan's military, something that the DPJ's pacifist wing staunchly opposes. Mr Ozawa's bunch are also at odds with other DPJ members over how to attack the LDP's pension reforms, which will be one of the biggest issues in the upper-house election campaign.

On May 11th most DPJ members voted against the government's reform package, which will gradually raise premiums and cut benefits over more than a decade, but backed an additional government plan to begin looking for ways to merge separate pension schemes for company workers, government officials and the self-employed. Mr Ozawa and other former Liberals, however, opposed the government's plans in full, and failed to show up for either vote. None of this bodes well for the party's future under the possible leadership of a man who many DPJ members always feared would turn out to be a cuckoo in the nest.

Although the DPJ has lost an important battle, Mr Koizumi has arguably been wounded as well, even if he is not forced to jettison any of his cabinet ministers over the scandal. A strong opposition, after all, makes it easier for him to take on enemies within his own party. So after losing both Mr Fukuda (who was his right-hand man) and his highly valuable opponent, Mr Kan, in short order, the prime minister may now find himself having to do a bit of scrambling of his own.

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Australia

Ready, steady, vote

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From The Economist print edition

A budget for an imminent election

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WITH an election due in a few months, the latest budget from Peter Costello, Australia's treasurer (finance minister), was fairly brazenly designed to win a fourth term for the conservative coalition government led by John Howard. By the time Mr Costello actually delivered it in Parliament on May 11th, so much had been leaked there were few surprises left—except, perhaps, the precise scale of the budget's new largesse: a package worth A$37 billion ($26 billion) over the next five years by a government that has staked its credentials over the past eight years on a record of fiscal restraint.

Middle-income families, working mothers and retirees, all among the swinging voters who could decide the election, were showered with payments. From July, for example, every Australian woman, rich or poor, who has a baby will receive an A$3,000 cheque from Canberra. There is relief on pensions' tax, and income-tax cuts worth almost A$15 billion.

The real drama, though, came in the budget's politics. It was largely overshadowed by renewed speculation about Mr Costello's own political future. This was his ninth budget, and he had appeared to indicate in an interview a few days earlier that he wanted it to be his last. His remarks were seen as a less-than-subtle signal to Mr Howard that Mr Costello's patience as leader-in-waiting of the conservative Liberal Party appears to be running out. Mr Howard last year dashed Mr Costello's hopes of a seamless leadership transition before the election. The prime minister turns 65 in July, but shows no sign of being ready to stand down in favour of his younger deputy if he wins.

The indications of rancour within the government are cheering for the opposition Labor Party. Under Mark Latham's punchy, if sometimes erratic, leadership, Labor had overtaken the government in pre-budget opinion polls. But Labor strategists are now preparing for an early election, possibly in August, if the budget proves popular. To be on the safe side, Mr Latham has now cancelled trips to America and China. With a budget cash surplus of only A$2.4 billion, halved from the previous year, Mr Costello has left Mr Latham little room for promises to match his own pre-election spending spree.

There are other incentives for the government to go for an earlier election. Australia's strong growth of almost 4% has been largely underwritten by a housing boom, which is now showing dangerous signs of turning to bust. The Reserve Bank of Australia, the central bank, reported on May 7th that house prices had fallen, on one measure, by 8.4% in the three months to March, with an even steeper drop in the two biggest boom cities, Melbourne and Sydney. The full budget acknowledges the risk of “a more widespread fall in house prices”.

If so, Mr Costello's budget largesse could be designed to cushion the pain for many in middle Australia who have saddled themselves with debt through buying second and third properties as investments. Mr Latham will make much of the government's leadership tensions. But his real challenge will be to come up with a convincing alternative budget package to the government's in what could be a very short time.

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China

Villa envy

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Emigration is being driven by relative, not absolute, poverty

Get article background

THE villages around Fuqing city in the southern coastal province of Fujian are architecturally eclectic. Decrepit old farmhouses with tiled roofs are interspersed with four- or five-storey western-style villas painted in bright colours with classical porticos. Farmers believe the best way to show off wealth is to build high. At funerals they sometimes burn paper models of tall villas to placate the dead.

A lot of villagers around Fuqing have new villas. But few have earned the money invested in them themselves. The land is not good for farming, fishing brings little reward and local factories prefer to hire cheaper labour from far inland. The area's ostentatious peasantry has mostly acquired its gaudy real estate with the help of remittances from abroad. Fuqing's rural economy is sustained by a custom of sneaking across international borders to find manual work that is ill-paid by western standards but many times more rewarding than farming in Fujian.

It is a hazardous path to fortune. In Zelang village, three families are trying to come to terms with the death of loved ones in Morecambe Bay in north-west England in February. The three deceased young men were among at least 20 Chinese illegal immigrants who drowned while gathering cockles. Four years ago, 58 Chinese, mostly from Fuqing and a neighbouring county, suffocated to death in a lorry transporting tomatoes across the English Channel.

The Chinese gangsters, or “snakeheads”, who arrange the journeys charge the equivalent of what an average peasant earns in a lifetime. Extended families often pool their incomes and borrow from other villagers or underground moneylenders to pay the snakehead fees for one family member to be smuggled abroad. Interest rates are steep: 1.5-2% a month in Fuqing's informal credit market. Someone caught trying to sneak out of the country illegally might be fined 10,000 yuan ($1,200) and detained for a couple of weeks if caught. The upside, though, is huge.

Relatives in Zelang say Guo Binglong borrowed 280,000 yuan ($34,000) to pay for his trip to Britain. His family lives in a spartan two-storey house built 20 years ago. “What we wanted was for him to go abroad and pay back his debt and build us a new house,” says a family member. The family reckoned that Mr Guo could earn 7,000-8,000 yuan a month in Britain. It would take him a few years to cover the debts incurred by his trip and his failed business ventures in Zelang. And then in another four or five years, perhaps, the family could have a nice tall villa.

Mr Guo's toils in Morecambe Bay enabled him to send back 40,000 yuan between late July last year and January this year, roughly what one of his brothers in Zelang earns in ten years driving a tractor. His family borrowed several hundred more yuan soon after his arrival in Britain to buy him a mobile telephone, which they mailed off to England. He used it to call his family in February to tell them he had been cut off by the incoming tide and that he was going to drown.

But the Guo family's sufferings, compounded by demanding creditors, are unlikely to have much impact on the exodus from Fuqing. Illegal emigrants from Fujian know that when they arrive in the West they can tap into extensive networks of Chinese from the same region. From Fuqing alone, with a population of 1.2m, many tens of thousands have been smuggled abroad, mostly in the past 20 years.

It is not desperate poverty that is driving them. Fuqing is quite well-off compared with much of rural China. As two sociologists, Liang Zai and Ye Wenzhen, argued in an essay several years ago, it is more a sense of “relative deprivation”. Or put crudely, villa envy. Mr Liang of the State University of New York at

Albany says potential emigrants “simply discount the chances of failure and tragedy”.

Britain only recently became the haven of choice after other popular destinations such as Japan and America tightened controls. Now Britain is trying to follow suit. This week, during a visit to London by China's prime minister, Wen Jiabao, the two countries signed a memorandum aimed at strengthening efforts to tackle illegal migration. Relative deprivation may one day help too. “I hope that in 20 years China will be better than Britain and then British people will emigrate here to work,” says a Fuqing resident, admiring a landscape studded with tall new buildings.

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Rebuilding Iraq

Without peace, reconstruction stalls

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AFP

Why it is proving so hard to rebuild the country

Get article background

IF THE Americans left Iraq today, their most obvious physical legacy, in the eyes of ordinary Iraqis, would be concrete blocks. The big slabs protecting administrators, soldiers and contractors from the 30-odd countries in the ruling coalition, which is due to be dissolved at the end of June in favour of an interim government run by Iraqis, jut into Baghdad's main roads and often reduce traffic in the capital to a standstill. Meanwhile, as the violence sputters on, the country's reconstruction—witness, for example, its communications system—is a shambles.

The insurgency, aimed at America's foreign and Iraqi contractors as much as the soldiers of occupation, is largely to blame. Last month 90 foreigners were kidnapped, prompting Russia, Portugal, Poland and France to urge their nationals to go home. Another bomb this week targeted a Baghdad hotel full of contractors. Kellogg Brown & Root, which has won the biggest building contracts in the new Iraq, has seen 34 of its staff killed, a higher toll than has been sustained by the military forces of any of America's allies bar Britain's.

Security squads and the protection of buildings, along with insurance and the soaring costs of transport on dangerous roads, account for as much as 30% of the costs of some of the companies trying to set up in business. The Californian building and engineering giant, Bechtel, which is handling contracts with the Agency for International Development (USAID) worth around $2 billion, has pulled half of its staff out to neighbouring Jordan and Kuwait and has assigned two Gurkha bodyguards to each of its 33 expatriates left in Baghdad. After last month's insurrections in Fallujah, to the west, and in Shia towns to the south, many of its key people have, for the time being, gone.

An official at the planning ministry, which oversees Iraq's reconstruction effort, says that productivity has slumped virtually to nil. When the militia of a rebel Shia firebrand, Muqtada al-Sadr, swooped through towns to the south of Baghdad, water, sewage-treatment and other projects were abandoned to scavengers, who stripped plants of machinery. Other than looters, the beneficiaries have been the 20,000-odd men working for security companies. They have blurred the lines between civilian and military contractors. Both are targets of the insurgents.

As the summer heat rises, many essentials are getting scarcer. The schools are still open and exams held on time. But after months of regular electricity at night, long power cuts have become frequent again, plunging the capital into darkness and increasing crime. Promises that by next month the country's output would have risen from 4,500 to 6,000 megawatts (the amount a biggish American town consumes) look unlikely to be kept, especially since all of Siemens's specialists and most of General Electric's have left. This week another Russian engineer was killed and two more kidnapped at a power plant, prompting a further flight of foreigners.

In their effort to achieve as smooth a handover as possible to Iraqis at the end of June, the American authorities are letting their generals make deals with the rebels to get the show back on the road. In Fallujah, the hottest cauldron of Sunni hostility, the marines have lifted their siege, leaving the insurgents to run the town's security; they have even staged a joint patrol. In Shia towns, including the holiest, Najaf, General Martin Dempsey has offered to turn Mr Sadr's lieutenants into “stakeholders” in seven battalions being set up within a new Iraqi army and to let Mr Sadr's foot-soldiers join it as recruits. The Americans would withdraw to outside the cities.

Who's a friend or foe, these days?

But while the former outlaws have enjoyed their rise to power in the towns, their friends are still blowing up supply lines. By sabotaging a pipeline, they recently cut oil exports from southern Iraq by nearly a half, according to the oil minister. They also destroyed many of the lorries in a 21-vehicle convoy near the Jordanian border and kidnapped several drivers. Mr Hussein's network of motorways, one of the few aspects of the country that worked, is riddled with craters from roadside bombs and from shells. Many supplies for the coalition, which imports most of its basics, including water, for fear of poisoning, are running short.

But incompetence and graft as well as violence are to blame for the failure of basic services to return even to the dismal level that prevailed under Mr Hussein. Much of Iraq's infrastructure, looted and burned when the old regime was toppled a year ago, is still a skeletal wreck. The foreign ministry will not re-open until the autumn. Its 1,400 officials work for only two days a week, due to shortage of space. Disillusioned officials say that the initials of the ruling Coalition Provisional Authority (CPA) stand for “Can't Plan Anything”.

Come June 30th, it will metamorphose into the American embassy and the Program Management Office (PMO), the body set up by the Pentagon to dispense American aid worth $18.4 billion in the first year after Mr Hussein's fall. But after six months in action, PMO officials say they are still discussing with Iraqis how to disburse the money. So far they have spent only 10% of it, largely to rebuild military bases. The CPA had hoped that the PMO's plans would mean 50,000 new jobs by next month. Instead, thanks to the violence, it has cut its 7,000-strong workforce in half.

The Iraqis' big hope is still oil—and its current exceptionally high price. They hope that annual revenue will rise from an estimated $12 billion for the current year to more than $20 billion. With some $8 billion left over from the UN's controversial oil-for-food programme administered during Mr Hussein's last years, that should provide a good slice for capital expenditure. Even under the original budget of $13 billion, 12% of it was marked for capital projects, a huge increase on past years.

A bad smell

But too much is already being wasted. The finance minister and Central Bank's governor, both appointees of Ahmed Chalabi, the Pentagon's favourite member of the outgoing, American-appointed Governing Council, have yet to open their books to public scrutiny. A previous conviction in a Jordanian court on a charge of massive fraud still damages Mr Chalabi's reputation; he says the verdict was politically driven. Several businessmen seeking security contracts say they have been asked by ministers and officials for bribes.

The biggest spending is on subsidies. A large chunk of the budget, some $4 billion, goes on food rations. Around $2 billion goes to keep petrol at one cent a litre. Such handouts helped keep Iraqis alive when public-sector salaries, in Mr Hussein's era, were frozen. But they have jumped seven-fold on average in real terms since his demise. Though unemployment is very high, most Iraqis are no longer dirt-poor. Yet CPA officials, who once sang the praises of the free market, have shrunk from slashing subsidies, for fear of raising discontent. A deputy minister has suggested doubling the value of a nearly-free food basket for

the poorest fifth who do rely on rations, while stopping rations for the rest.

Under UN resolutions, Iraq's oil revenue still goes via the UN's Development Fund for Iraq and is then disbursed by the CPA. The UN is formally obliged to hand control of the revenues directly to Iraqis when they have an independent, representative and recognised government. The interim government after June 30th may not qualify. Iraq Revenue Watch, a New York-based group that monitors abuse, says the Americans should let Iraqis take full control of their oil—and the revenue it brings in—as soon as possible. That, at least, should help pay for reconstruction. But without peace it will continue to falter, whoever is in charge.

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Abuse in Iraq

The view from within

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Why Iraqis themselves are less shocked by the mistreatment of prisoners

Get article background

EPA

Let my boy out

MANY of those Iraqis who rely on their local press are bemused by the global furore over the abuse of detainees in Abu Ghraib prison. The impending court-martial of an American soldier accused of sexually abusing Iraqis got barely a column inch on the front page of one of Iraq's best-selling papers, *Al Mashriq*. Street protests against the abuses of prisoners were much smaller than those held at the behest of Shia clerics calling for direct elections.

Why the insouciance? For Iraqis, torture and jail go together. The methods portrayed in the photographs were mild compared to those of Saddam Hussein, whose interrogators often got detainees to talk by abusing their wives and daughters in front of them. Iraqis were less shocked this time by the abuse than by the fact that some abusers were women. “We're used to male wardens stripping females, said a former Baathist officer. “The reverse is just perverted.”

Moreover, while the ghastly reports from Abu Ghraib horrified people in the West, the ruling coalition had long since lost its innocence in Iraqi eyes. Promises of freedom and democracy may be believed in far-away America, but long ago became incredible to Iraqis as the violence worsened and the counter-insurgency got harsher. Mr Hussein kept 5,000-odd detainees in Abu Ghraib jail, remarked a local human-rights campaigner, while the Americans have held some 7,000 there.

Nor were the allegations new. The International Committee of the Red Cross (ICRC) had repeatedly aired its concerns. Thousands of ex-inmates bore the scars of the nylon cuffs which held their hands tightly together behind their backs. If they wanted to defecate, they said, soldiers pulled down their trousers. Many said they had been stripped naked of all clothing, bar the ubiquitous hood, and subjected to kicks and beatings. The news agency Reuters protested in January that three of its employees had been detained and tortured for three days in January, enduring sleep deprivation, “stress positions” and shoes stuffed in their mouths.

Yet no one in authority, it seemed, was listening. The ruling coalition's “assistance centre” in Baghdad, which can arrange compensation for Iraqis mistreated as a result of the occupation, dismissed claims of torture out of hand. Iraqi translators were told to assure worried families that detention was humane. The American army said it needed evidence before a complaint could be processed, including the name of the officer in charge, which sightless detainees invariably could not provide.

Requests from human-rights groups and journalists for access to the jails were routinely dismissed. This correspondent was denied even a telephone interview on the subject of detainees. Only the ICRC, which kept its comments private until its report was leaked, gained admission. Much interrogation work was done by private firms, such as the Californian TitanCorp, which claimed commercial confidentiality if asked about safeguards.

This web of secrecy has nurtured a climate in which abuses can flourish. Renaissance Services, a British-run catering company feeding the American army inside Baghdad's administrative headquarters (known as the Green Zone), justified its refusal to talk about a strike after claims of abuses because it was under contract not to talk to the press. And the fact that the scandal has erupted in Washington makes many

Iraqis think that the ruling authorities respond only to an American public.

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Iraq and the Arab world

Ice-cold contempt

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Why the “Arab street” has not sounded as furious as it might have

Get article background

SINCE the scandal over the American treatment of Iraqi prisoners erupted, the so-called Arab street has gone eerily silent. Certainly, commentators and café pundits have made plenty of hay over the superpower's shame. Yet the volume of outrage is less than might have been expected.

The silence is not the sound of forgiveness but of ice-cold contempt. If Arabs seem surprisingly unshocked by the hideous imagery, it is because they see it not as an aberration but as viscerally satisfying proof of the underlying nature, as they see it, of America's brash intrusion on to Arab soil. The cheap supremacist posing of a few reservists is seen as the logical consequence of America's higher-level posturing as what a prominent Saudi businessman calls “the region's dominatrix”.

Serious as it is, the Abu Ghraib scandal is only one in a string of indignities that Arabs perceive to have been heaped on them over the years. Long before September 11th, they cringed at seeing themselves depicted as Hollywood's seemingly favourite villains and bridled at what they see as America's apparently reflexive backing for Israel, right or wrong. In Arab eyes, the war on terror all too often took on shades of a broader hostility to Arabs and Muslims. Hence the Arabs' overwhelming opposition to America's invasion of Iraq.

“They ask us not to judge America by the Abu Ghraib guards,” says the well-heeled Egyptian agent for several American defence firms. “So why did they judge all Arabs by the 9/11 hijackers?” Such is the pain of the dwindling number of friends America has in the Arab world; some of the sharpest criticism of America, notes a western diplomat, now comes from Arab liberals who had shared American hopes of a democratic domino effect.

Among the larger number of Arabs predisposed to dislike America, the language is harsher. For Islamists, the sexual assault on Muslim dignity doubly confirms America's supposed secular depravity and a lingering Christian vindictiveness harking back to the crusades. One Islamist website gloated over this week's videotaped beheading of an American captive in Iraq.

Arab autocracy means that such feelings have yet to express themselves in political terms. Some analysts say, however, that Syria has felt able to ignore American demands, so prompting Mr Bush this week to impose long-threatened but limited economic sanctions, because some influential Syrians now predict an American failure in Iraq that means the superpower will soon be wary of telling weaklings such as Syria what to do. (The sanctions, which will cut the small volume of trade between the two countries, are punishment for Syria's alleged pursuit of chemical weapons and support for terrorist groups.) Others say that for the foreseeable future an American imprint on any policy proposal, such as the mooted Greater Middle East Democracy Initiative, will be a kiss of death.

A bevy of top Americans, including the secretary of state, Colin Powell, and the national security adviser, Condoleezza Rice, are on their way, to try to soothe Arab sensibilities. Mr Bush has bowed to Arab demands by sending a palliative letter to Palestine's prime minister, Ahmed Qurei. Despite having earlier appalled Arabs by endorsing plans by Israel's leader, Ariel Sharon, for a withdrawal from Gaza that would leave many Jewish settlements in the West Bank intact, the letter said that America “will not prejudice” the outcome of negotiations over the “final status” of the two states, including their borders.

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Côte d'Ivoire

Blue-helmet blues

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AP

The UN's tough task in Côte d'Ivoire

Get article background

THE UN peacekeepers in Côte d'Ivoire think their mandate is clear: to provide stability, so that elections can be held in October next year. Many Ivorians, however, want them to take sides. “The UN is here for one thing, and one thing only: to disarm the rebels,” says Charles Blé Goudé, the leader of the Young Patriots, an important and rather menacing pro-government group. “If the blue helmets haven't started disarming them within a month,” he told a recent rally, “I will not be responsible for what happens to them.”

Since September 2002, when a rebel group seized control of the northern half of Côte d'Ivoire, life has grown steadily less secure. The civil war was declared over last July, after France, whose troops had done an impressive job of keeping the two sides' soldiers apart, pushed their leaders into a “government of national reconciliation”. But that government has stalled. The rebels feel that their main grievance—discrimination against northerners and Muslims—has not been addressed. They still hold half of the country, which infuriates southerners.

Kill the French

Sanson Kouao, a rich farmer, won huge cheers from the 20,000-strong crowd at the recent Young Patriots' rally by musing about killing all 4,000 of the French troops who are supporting the UN in Côte d'Ivoire. The Young Patriots argue that the French, by preventing the Ivorian army from smashing the rebels, are in effect siding with them. The Young Patriots' strings are pulled, reputedly, by President Laurent Gbagbo himself, whose wife attended the demonstration.

The baseball-cap-wearing Mr Blé Goudé is threatening to lead a Young Patriots march in the main rebel-held city, Bouaké, on May 22nd. He says the UN must guarantee the marchers' security. He knows it cannot—the place is packed with gun-toting rebels, and the Young Patriots are spoiling for a fight. His game may be to tout the UN's inevitable refusal as proof that it supports the rebels. The rebels' political proxies hold demonstrations in the government-held south, he argues, so why shouldn't he and his chums do the same in the north?

There was indeed an anti-government rally in the south on March 25th. It was banned and, according to a UN report leaked last week, 120 of its organisers and sympathisers were carefully murdered by the security forces and pro-government militias. The rebels' leader, Guillaume Soro, suggested that President Gbagbo should be put in the cell next to Slobodan Milosevic. The government accused the French radio station that aired the report's findings of seeking to overthrow it.

When opposition leaders held a multi-faith ceremony to mourn their dead, the UN provided protection. Mr Blé Goudé says this was unfair, as the UN has not offered similar protection to the Young Patriots' rallies in the south.

Mr Soro insists that his men will disarm, but only when the pro-government militias do, too. He would like the UN to enforce this, and to patrol the streets of Abidjan, the economic capital, which is on the south coast. In effect, the rebels are asking for the UN to take responsibility for Côte d'Ivoire's security. That is a tall order, but someone should.

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Russia and Chechnya

A gaping hole

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AFP

After the killing of Chechnya's president, who will be popular, capable and sane enough to take over?

WHO but a masochist would want to run Chechnya now? Akhmad Kadyrov, assassinated on May 9th, was the third of the province's four post-Soviet presidents to meet a violent end. Jokar Dudaev, who led Chechnya's first bid for separatism from Russia, was killed by a Russian missile in 1996. Zelimkhan Yandarbiev, his successor, was blown up last February in Qatar, where two Russian agents are on trial for his murder.

Mr Kadyrov was the Kremlin's main hope for solving the mess Chechnya has become over the course of two wars between Russian forces and separatist rebels. A former mufti of Chechnya and ally of the rebels, he switched sides, becoming the Kremlin-appointed administrator in 2000. Last October he “won” a presidential election in which turnouts were inflated and other serious runners excluded. For Vladimir Putin, Russia's president, the task of Mr Kadyrov was to validate the policy of “Chechenisation”: the idea that putting the region in Chechen hands, with a bit of autonomy (not independence), could succeed where brute force failed.

The assassination has scuttled that idea. It showed signs of having inside help. A bomb had been embedded in concrete, apparently during renovations, below the VIP stand in the stadium in Chechnya's capital, Grozny, where Mr Kadyrov was presiding over second world war victory celebrations. It was detonated either by a timer or by remote control through a wire; the culprits apparently knew not to use a radio-controlled device, since the stadium reportedly had jamming equipment to foil such attacks. They also killed two bodyguards, a photographer and a child—and badly hurt the Russian commander in Chechnya, General Valery Baranov.

It was only the latest of something like 15 assassination attempts, for Mr Kadyrov had no shortage of enemies. Many officers still hated him from his rebel days, when he called for a *jihad* against Russia's army. Various rebel warlords loathed him as turncoat. His chosen instrument for subduing the province was a brutal militia, known as the *kadyrovtsy*, commanded by his son Ramzan; they are accused of killing, kidnapping and looting at will. Some Russian nationalists said Mr Putin was handing Mr Kadyrov too much power. He was also said to have alienated the local Russian garrison, by muscling in on some of the scams—such as illicit oil refining—that have made the conflict less a struggle over politics than a scrabble for profits.

A hard act to follow

Few, one might think, would mourn such a man. Yet human-rights workers agree that in recent months, under Mr Kadyrov's heavy hand, a thin veneer of normality had started to return to Chechnya. Shamil Beno, a former Chechen foreign minister and now a social activist, says that the *kadyrovtsy* had brought the multitude of checkpoints scattered through the republic “under some kind of control”; there were fewer explosions and rebel attacks. War refugees had begun getting compensation from the federal government, albeit paying bribes to do so. Cafés and shops were beginning to open among Grozny's ruins.

Whether Mr Kadyrov would have made much further progress is debatable. But one of his advantages to Mr Putin, who became president on a promise to subdue Chechnya swiftly, was the fact that “Chechenisation” allowed him partly to wash his hands of the resulting mess. He is not likely to opt for direct presidential rule again, as some nationalist politicians are now urging.

The problem is who could succeed Mr Kadyrov. Elections will be held on September 5th. Like last time, Mr Putin will probably not leave their outcome to anything so unreliable as the electorate. Still, many of those who had hoped to run against Mr Kadyrov last October may feel they have a chance again. Some, according to polls at the time, could have beaten him in a fair election, most notably Malik Saidullaev, a Chechen businessman living in Moscow. In the tribal world of Chechen politics, people tend to have local power bases (Mr Kadyrov's was his home village of Tsentoroi, Mr Saidullaev's is the town of Alkan-Yurt) but often lack wider support. Most have spent too long outside Chechnya. Mr Kadyrov was more credible than average: his background as mufti, his time with the rebels and his experience as administrator gave him a unique mixture of levers of influence.

The biggest such lever was the *kadyrovtsy*. Estimated to number anywhere from 1,500 to 5,000, they are a nasty mix of convicts, ex-rebels and ex-soldiers, only loosely under control. Ramzan Kadyrov is too young, at 27, to be president, but whoever takes over will need him and his militia on side to avoid adding another layer to the conflict. In a nod to that, he was made deputy prime minister of Chechnya after his father's death. A Kremlin aide has already described Ramzan as “de facto” leader of Chechnya pending the election of a new head of state.

That will leave the next president hemmed in on all sides by the *kadyrovtsy*, the army, the rebels and the Kremlin, with precious little room for manoeuvre. He will be highly vulnerable: Mr Kadyrov's assassination was only the latest in a series of attacks, among them a car-bomb in December 2002 that destroyed the Chechen government headquarters in Grozny. If he has any sense, he will avoid making enemies; and if he avoids making enemies, he has no hope of making progress in resolving the conflict.

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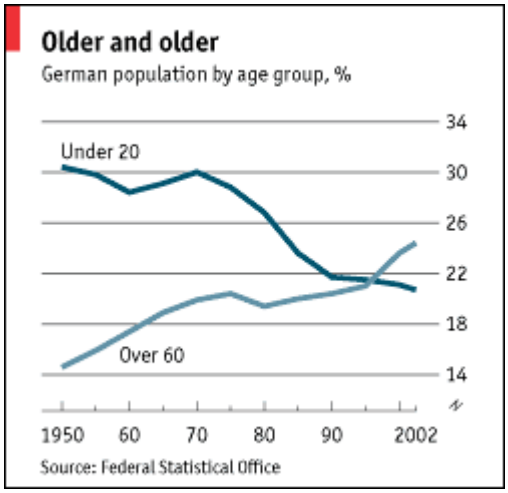
German demography

Old dogs, new tricks?

May 13th 2004 | BERLIN
From The Economist print edition

Debating population policy is no longer taboo



IF GERMANY'S body politic is good at one thing, it is getting into a tizzy. Last week, the excitement was over the damage the ruling coalition of Social Democrats and Greens might suffer from a new immigration law. This week, the question is whether Hans Eichel, the finance minister, will have to go if the government borrows more money to cover huge tax shortfalls. Yet if you think Germany, in a year with more than a dozen elections, is all about short-term politics, think again. At last, Germany's chattering classes are facing up to the country's biggest long-term challenge: an ageing population. “In Germany, 2004 is the year of demography,” says James Vaupel, executive director of the Max Planck Institute for Demographic Research in Rostock.

After half a century of obscurity, population issues are resurfacing in headlines, bestseller lists and talk shows. When in April the Berlin Institute for World Population and Global Development, a think-tank, issued a study saying which regions will suffer from a shrinking population, it was amazed by the media interest. And Germany's bestselling book is “Das Methusalem-Komplott” (The Methuselah conspiracy), an anti-ageism tirade by Frank Schirrmacher, a co-publisher of the *Frankfurter Allgemeine Zeitung* newspaper.

Both publications paint a bleak picture. Some regions are in a death spiral of sorts, says Reiner Klingholz, one of the authors of the study—and others may share that fate in years to come: their population is imploding, not just because of a lack of babies but because young, qualified people are moving away, making many regions even less attractive for job-creating investments. Mr Schirrmacher fears a clash of the generations and wants a cultural revolution to rethink what it means to be old.

If Germany has suppressed its demographic problems for so long, it is mainly because of its Nazi past. Population policy sounded like racial policy. Even today, the country has only four university chairs in demography. There are many reasons Germans are waking up now, says Elisabeth Niejahr, author of a forthcoming book entitled “Altenrepublik” (Republic of the Old): the financial woes of public pension funds and the health-care system; unification (most imploding regions are in the east); and the fact that Germany's baby-boomers (like the 44-year-old Mr Schirrmacher) are beginning to be elderly.

Ms Niejahr's book is another sign that the debate is moving beyond numbers. She says Germany's ageing will affect not just pension funds, but the whole of society—how people “live, work and love”, to quote her subtitle. What does it mean for entrepreneurship and economic risk-taking if more than one-third of the population is older than 60? How must firms reorganise to use old people's experience and ideas? How can immigrants be integrated?

In the same vein, a recent study by Deutsche Bank looks at what a shrinking and ageing population will mean for public infrastructure. Intuition suggests that the state will need to spend less. In fact, maintaining acceptable road, utility and school systems may well become more expensive. Although the number of students in Germany will go down by about a third by 2050, for instance, costs per student will most likely go up because schools need to be kept open in less populated areas.

It is unlikely that politicians will deal with such long-term issues in time, given their slowness to tackle problems that will arise even sooner. Instead of pushing on with structural reform, the Social Democrats are talking of ditching the budgetary rigour demanded by the European Union. They have revived the

Iraq war as a campaign issue to avoid disaster at the European elections in June. Meanwhile the opposition conservatives, while vowing to promote necessary reforms, are dragging their feet over details. Perhaps the only hope is that an older Germany will start turning into a wiser one—soon enough to avoid disaster.

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EU and China

Pander complex

May 13th 2004
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Looking for ways to please a new friend

FITTINGLY, for two up-and-coming “strategic partners”, as the European Union and China now like to think of themselves, it was red carpets all the way for China's prime minister, Wen Jiabao, on a five-nation tour that took him to Brussels, Rome and Berlin, and this week to London and Dublin. With the EU now rivalling the United States and Japan as trading partner and investor for China's burgeoning economy, China's new leaders have been assiduous in their courtship. The Europeans, keen to offset a huge trade deficit, lined up along Mr Wen's route to promote new agreements and contracts on everything from sustainable development to space technology. Yet one prize eluded Mr Wen: a long-sought promise to lift the EU's 15-year-old embargo on arms sales to China.

Seen by some in Europe as outdated, anachronistic and a residual tarnish on an otherwise shiny new relationship, the lethal-weapons ban was slapped on after the Tiananmen Square massacre of democracy activists in 1989. But France has been lobbying against it for some months. Earlier this year, President Jacques Chirac called formally for it to be lifted; keen to please China's visiting president, Hu Jintao, he also criticised Taiwan's plan for a controversial referendum (China has long threatened force should Taiwan, which it claims as its own, move towards formal independence). Germany's chancellor, Gerhard Schröder also favoured scrapping the embargo, and others agreed. Why, they asked, bracket China with Myanmar, Sudan and Zimbabwe, three pariahs under a similar ban? Yet so far the embargo, though not quite watertight, endures.

China has changed a great deal since Tiananmen, yet some of those locked up in 1989 are still not free, point out human-rights watchers. The death penalty is widely applied, and people still get locked up for their political or religious beliefs. China recently suspended its human-rights dialogue with America after it introduced a critical resolution at the UN Human Rights Commission. The EU, for its part, is still pressing China to ratify the UN's Covenant on Civil and Political Rights. Meanwhile, Mr Schröder, in particular, was unkeen to pick a fight now over the embargo with his Green partners ahead of next month's European elections.

Lifting the embargo would cause other problems. The United States has lobbied hard against the idea. Pledged to help defend Taiwan should China's threats ever turn to outright aggression, America would take it “quite personally”, says one senior administration official, should China be able to rely on weapons supplied by NATO allies. What is more, under pressure from successive NATO secretaries-general, the State Department and the Pentagon have been working to apply America's restrictions on transatlantic collaboration in high-tech weapons and sensitive technologies more selectively. Britain hopes to win Europe's first formal exemption from some of these curbs. Yet Congress must approve such deals, and will take a dim view if the EU declares itself open for arms business with China.

That, say EU officials, is not quite what is under discussion. Rather, ways are being explored to tighten up and make more transparent the EU's catch-all code of conduct on arms transfers. This calls for export licences to be denied where equipment might be used to abuse human rights, assert territorial claims by force, upset a regional balance or harm the interests of friends and allies. But the code is not binding. It will be hard for the EU to please its new friend, China, without offending is oldest friend, America.

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Council of Europe

A breath of fresh air?

May 13th 2004 | RIGA
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Estonia's Kristiina Ojuland could reinvigorate Europe's moral watchdog

AP

RAGING against the Council of Europe recently, Georgia's president, Mikhail Saakashvili, called its secretary-general, Walter Schwimmer, “an impudent and well-paid bureaucrat”. Mr Saakashvili wishes the Austrian had backed Georgia's reassertion of control over Ajaria, a rebel region, rather than urging restraint. Events have vindicated Mr Saakashvili; Ajaria remains peaceful. But his rebuke was off target; the problem with Mr Schwimmer—and the Council of Europe—is that they are not impudent enough.

If you were grading international institutions for having a dull-but-worthy image, on an index of one to ten, then the Strasbourg-based Council of Europe would rate a dozen points or so. Founded in 1949, it is older and bigger (with 45 countries) than the 25-member European Union, and much less muscular. But its goals are lofty: defending human rights, the rule of law and democracy.

There are, of course, other bodies—such as the EU and NATO—which aspire to promote democracy in Europe. But precisely because those bodies wield hard political power, they often compromise on their ideals: when you are doling out military aid or trade deals, you cannot always reward democratic behaviour, and punish the opposite, with perfect fairness. The Council of Europe has the potential, at least, to keep its moral authority intact.

Does it fulfil that potential? A lot of the time, it seems becalmed in a sea of polite conversation and political correctness—though attempts by the council's parliamentary assembly to investigate Russia's war in Chechnya are an honourable exception. It will have to move more boldly, if it is to have any hope of impressing the citizens of old and new Europe.

An opportunity will soon present itself. Next month the council chooses a new secretary-general, who will steer its priorities and serve as its public face for the next five years. All three candidates are very worthy. But by some oversight, only two of them are dull. The non-dull one is Kristiina Ojuland, 37, foreign minister of Estonia, and until 2002 leader of the liberal block in the Council of Europe's parliamentary assembly. There are several good reasons why the assembly might want to vote her in.

Some of the council's best work lies in helping the stragglers among southern and eastern European states to keep alive their hopes of integrating with the West. Ms Ojuland is from a country that moved from post-Soviet chaos to market democracy; she can lead from the front.

The council is supposed to defend democratic values, but it has been so keen to embrace new members recently that it has let standards slip. Ms Ojuland is a tough-minded liberal who may just make the council a more effective watchdog. Last but not least, Ms Ojuland is not a middle-aged male from western Europe.

She will approach next month's vote as the underdog, trailing Mr Schwimmer, a conservative, and Terry Davis, a British socialist who lost narrowly to Mr Schwimmer in 1999. But they, for all their solid virtues, are unlikely to push hard for change. It may now be time for the council, for once in its worthy but consensus-cramped life, to live a little differently.

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French medicine

The price of popping pills

May 13th 2004 | PARIS
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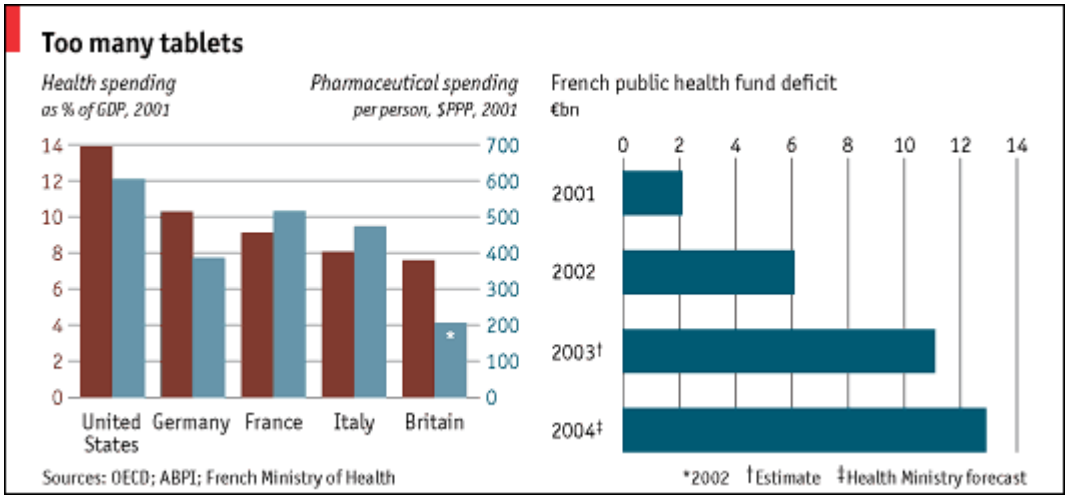
Behind French medicine's glittering façade, crisis looms

ITS hospitals gleam. Waiting-lists are non-existent. Doctors still make home visits. Life expectancy is two years longer than average for the western world. With such a shining bill of health, the French medical system has good reason to boast. So why is the “crisis” in health care France's hottest political issue? Because of a near-bankrupt public health-insurance system, whose deficit is set to leap from €13 billion ($15.5 billion) this year to €229 billion by 2010 unless radical surgery is performed.

France's public health-insurance fund reimburses about three-quarters of medical costs; the rest are covered by private insurers, mutuals or (for the poor) the state. In the 1990s, this fund's deficit bumped up and down with the economy. But since 2001 the hole has widened (see chart), and become the main cause of a budget deficit which busts European Union rules.



Only about half the recent financing gap is due to the economic downturn. The other half comes from demands: from an ageing population, more expensive medical technologies, and a culture of rampant consumption. Philippe Douste-Blazy, the health minister and a former cardiologist, has called the system “mad”.

For the patient, the French health system is still a joy. Same-day appointments can be made easily; if one doctor's advice displeases, you can consult another, a habit known as *nomadisme médical*. Individual hospital rooms are the norm. Specialists can be consulted without referral. And while the patient pays up front, almost all the money is reimbursed, either through the public insurance system or a top-up private policy.

AFP

For family doctors too, liberty prevails. They are self-employed, can set up a practice where they like, prescribe what they like, and are paid per consultation. As the health ministry's own diagnosis put it recently: “The French system offers more freedom than any other in the world.”

All this freedom, though, comes at a price. There is no incentive not to indulge the slightest twinge. The French go to the doctor more than twice as often as the Swedes. Comfort often triumphs over real

need. French mothers stay in hospital for an average of five days after giving birth; in America, the average is two days. Precaution can over-rule common sense. Nearly two-fifths of antibiotics prescriptions are useless, says the health ministry. As one French doctor puts it: “Doctors prescribe antibiotics for children with throat infections just to reassure anxious parents.” And the system is poorly co-ordinated, as the thousands of deaths in last year's heatwave showed. The upshot is that, in Europe, France's spending on health is second only to Germany's; and the French are champion pill-poppers.

Overdue for treatment

So what is the cure? In theory, the financing gap could be filled almost overnight by hiking the *contribution sociale généralisée* (CSG), a widely-based revenue tax. A rise of just one percentage point would bring in some €10 billion a year. But Mr Douste-Blazy hopes for a sustainable reform that does not simply “raise contributions and limit reimbursements”. Various ideas are under discussion. Some involve tinkering with the architecture. For instance, Mr Douste-Blazy wants to set up a national health authority to determine which drugs are useful. He also aims to unite fragmented public health-insurance funds, and broaden management away from the unions, which now run them. Another idea: ask all patients (save those on benefits) for €1-2, with no reimbursement, every time they see a doctor. This could haul in over €1 billion a year.

Most reform ideas, though, turn on that familiar fall-back: eliminating waste. Mr Douste-Blazy wants, for instance, to put photos on France's credit-card-style health cards, to curb fraud. He wants to set up and computerise shared health records, so that information can follow the patient and reduce duplicated tests. Other changes could limit the number of visits to the doctor for the same complaint; launch a referral procedure for consulting a specialist; or encourage doctors to practise in less attractive places (there are more doctors on the Riviera than in the rural centre). The government thinks it could wring €6 billion-7 billion a year from such measures.

None of this adds up to the radical overhaul that some analysts advocate. There is no plan, for instance, to inject a new element of competition, whether between insurers or suppliers of health care. Nor is the financing clear. But in any case, some reforms require common sense, not heroism. In one pilot study, Groupama, an insurance firm, set up groups of (usually isolated) doctors to share best medical practices. This cut health spending over 18 months by 3%, against an increase of 14% in areas outside the test.

Any reorganisation, however, will meet stiff resistance. Negotiations with unions over managing the funds are proving tricky. As it is, the government is battling with unpopularity, and Jean-Pierre Raffarin, the prime minister, is holding on to his job by a thread. So far, he is being cautious, insisting that the most dreaded measure—a rise in the CSG—will not be a “precondition” of health reform.

Really? Even with the other reforms, it is hard to see how else the deficit can be controlled. “In the long run,” says Jacques Delpla, an economist at Barclays Capital, “France cannot avoid raising the CSG.” The most likely scenario now looks to be a reorganisation plan before the summer, followed by the tax rise later—but only after concessions on other reforms have been secured.

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Charlemagne

We told you so

May 13th 2004
From The Economist print edition

Old Europe views the Iraqi mess with growing detachment

"WE SEE Iraq as a very complex country, with many different ethnic groups, a tradition of violence, and no experience of democracy. You can't create democracy with bombs." So wrote Jean-David Levitte, the French ambassador to the United States in the *New York Times* in February 2003, justifying his country's opposition to the impending American invasion of Iraq. As the United States sinks deeper into trouble in Iraq, the European countries that opposed the war are resisting the temptation to gloat—at least in public. But "Old Europe" also seems less and less inclined to try to lend a helping hand. As a result, the transatlantic rift that opened up because of Iraq shows little sign of healing. On the contrary, it may widen.

As recently as a couple of months ago, it seemed that even France and Germany might eventually be persuaded to play some positive role in Iraq. But as the security situation has deteriorated, the notion that more European countries might be persuaded to commit troops to Iraq—perhaps under NATO or the UN—has lost plausibility. The struggle now is to persuade those already there, like the Italians and Poles, not to follow the Spanish and pull out. Philip Gordon of America's Brookings Institution, who has just co-authored a study of the diplomatic crisis over Iraq ("Allies at War", published by McGraw-Hill) says: "Until a couple of months ago, I was optimistic that Europe and America could put this behind us." But he is now "deeply pessimistic" about the chances of a new transatlantic accord over Iraq, at least until after the American presidential election.

A well-placed EU diplomat agrees. He argues that almost everybody thinks that the Americans are now looking for a way out. "People don't want to be associated with something that looks much more likely to be a failure than a success. There is also a suspicion that it may anyway be too late for the mantle of internationalism to have any effect on the ground in Iraq."

The day-to-day situation in Iraq itself is sufficiently alarming for worries about the long-term future of the transatlantic alliance to seem a little abstract. But on a range of issues—terrorism, trade, Palestine, China—co-operation and agreement between the United States and Europe still matters hugely. The concern now is that the Iraqi mess will embolden those in Europe who want to portray America as a dangerous, immoral power that needs countering. Already, European politicians have won elections by running against the American government. Gerhard Schröder blazed the trail when he came from behind to win the German election of September 2002 by attacking the Bush administration over Iraq. José Luís Rodriguez Zapatero repeated the trick in Spain, campaigning against the "illegal and unjust war" in Iraq—and gaining an unexpected victory after the Madrid bombing of March 11th made his arguments seem more attractive to Spanish voters.

When Bush-bashing pays

Now Romano Prodi, who shamelessly combines the role of head of the European Commission with that of leader of Italy's left, is trying the same tactic. This week election posters went up in Italy, featuring a smiling Prodi next to the slogan: "Iraq, a mistaken war". Those who hoped the Madrid bombing would convince Europeans they are part of the same "war on terror" as America have been disappointed. On the contrary, one prominent member of the European Commission sums up the conventional wisdom as follows: "Because of the Iraq war, the threat of terrorism is now ten times worse than when Saddam was in power." As Bill Drozdiak, head of the Brussels-based Transatlantic Centre, sees it: "Europeans see the biggest threat to their security as Americans dragging them into a foreign war."

As the possibility of serious European engagement in Iraq recedes, so it becomes easier for European

politicians to retreat into sloganising about Iraq: calling for the withdrawal of troops, a UN presence and a sovereign Iraqi government—while gliding over the tiresome details of just how all this might be achieved. If “old Europe” has a policy on Iraq now, it is to pray for a Kerry victory in November. But they may be disappointed even if their prayers are answered. Charles Kupchan of America's Council on Foreign Relations argues that while “Europeans are hoping that a Kerry administration would execute a 180-degree turn on foreign policy, it's more likely to be a 20% adjustment.” Mr Kerry was swift to condemn the withdrawal of Spanish troops from Iraq. And he is unlikely to endorse two other key elements of old European conventional wisdom—the notions that a Middle East peace deal is there for the taking, if only America would put pressure on Israel; and that American military action can be legitimate only if it receives the prior approval of the UN.

Such disagreements suggest the estrangement between much of Europe and the United States goes well beyond Iraq and the policies of the Bush administration. Mr Kupchan has just directed a Council on Foreign Relations report on “Renewing the Atlantic Partnership”, which features the distilled wisdom of luminaries such as Henry Kissinger and Lawrence Summers, the president of Harvard. It makes some ho-hum recommendations about the need for Europeans and Americans to “make an effort to achieve a common position” on the Israeli-Palestinian conflict and “to agree on the role of multilateral institutions”. And it ends on a note of obligatory optimism about the possibility of “enlightened leadership”, restoring the Atlantic partnership. Yet the report also considers a darker scenario: “If Europe defines its identity in terms of countering U.S. power, the world is likely to return to a balance-of-power system reminiscent of the era prior to World War I—with the same disastrous consequences.”

The idea that Europe and America might actually come into armed conflict still seems absurd. But the notion that Europeans and Americans may increasingly be rivals rather than partners seems less implausible than it once did.

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Politics and Iraq

Soldier blues

May 13th 2004
From The Economist print edition

British soldiers come off better than American ones from accusations of abuse of Iraqis, but it isn't doing the government much good

Get article background

GEOFF HOON is no Donald Rumsfeld and, thankfully, the accusations about the behaviour of British troops in Iraq which the British defence secretary has had to deal with are, though serious, a good deal less ghastly than the scandal threatening to bring down his American opposite number. That is some comfort to Tony Blair, but not much.

On May 10th, Mr Hoon, who has been allowed to plod on in his job since his slightly surprising exoneration by Lord Hutton, gave a sober and (for him) quite convincing account of the extent to which British soldiers had been involved in the abuse of Iraqi civilians. He had to deal with allegations from three quarters: the report, completed in February, of the International Committee of the Red Cross into the treatment of detainees by coalition forces in Iraq; a more recent investigation by Amnesty International into the killing of 37 civilians by British soldiers; and, lastly, photographs published the week before by the *Daily Mirror* apparently showing an Iraqi being brutalised by men from the Queen's Lancashire Regiment.

Mr Hoon made no attempt to play down the gravity of the allegations. He also made an unreserved apology to any Iraqis who had been mistreated by British forces. He maintained, however, that while ministers had not seen the Red Cross report until very recently, each case involving British forces had been reported to senior officers or the Ministry of Defence (MoD) by soldiers and had been dealt with several months before the report was finalised. Of 33 cases of death, injury and ill-treatment, six investigations were still under way, 15 cases had been resolved and 12 were yet to be looked into.

Although the Red Cross commented on one troubling incident in which nine men arrested by British soldiers in Basra last September were so badly beaten up that one had died, there was nothing to compare with either the scale or systematic nature of the abuse unearthed in Abu Ghraib, the American-run camp. The use of hoods during interrogation at a camp run by the British, Umm Qasr, had been quickly stamped out.

The Amnesty International report detailed many individual tragedies of the kind that happen all too easily when jumpy troops with automatic weapons are given the job of policing civilians. Amnesty was also critical of the quality of the army's own investigations into possibly unlawful killings. Mr Hoon promised to take the concerns raised seriously and said that since March, the MoD had been trawling through the records of units to see if any case demanded more formal investigation and legal action.

As for the *Daily Mirror*'s pictures, the government is now convinced, along with almost everyone except Piers Morgan, the newspaper's editor, that they are fakes. It seems that an army truck that figures prominently has never actually been in Iraq. Mr Morgan's defence that the *Mirror*'s exposé did not rely on the authenticity of the photographs alone may not save his neck. But after the ill-fated campaign by Alastair Campbell, Downing Street's former communications director, to “fuck” Andrew Gilligan, the reporter who accused it of sexing-up the dossier on Iraq's weapons of mass destruction, the government will leave the hounding of Mr Morgan to others.

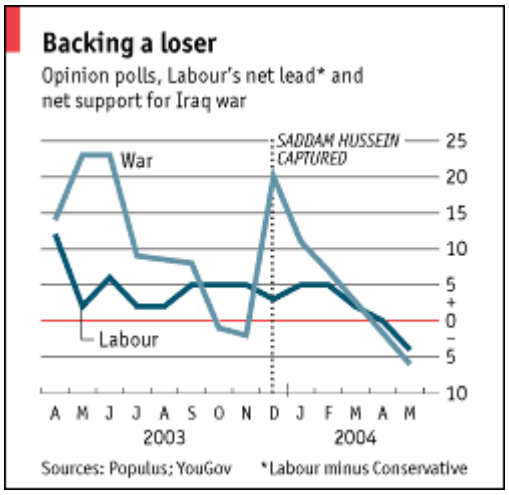
That does not mean the government is entirely off the hook. The claim that no minister was even aware of the Red Cross report until some time last week does little to encourage confidence in the way things in Iraq are being handled. It seems extraordinary that even if there was nothing new in the report as far as senior officers were concerned, they did not think to warn their political masters that they were sitting on

such damaging material.

The impression conveyed is not so much of attempted cover-up, as some have suggested, but of incompetence. The Tories' contention that nobody in government is in charge of what is going on in Iraq is gaining traction.

That matters, but not nearly so much as the damage done by the revolting images from Abu Ghraib to Mr Blair's claim that for all its faults and problems, the coalition is engaged in a profoundly moral enterprise (see article). Support for the war is slipping fast (see chart). The government's popularity is declining with it.

Mr Blair is still hoping that after the transfer of power to the interim Iraqi government on June 30th there will be some respite. But, on past experience, the bad news from Iraq will continue to drive out the relatively good news at home.



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Arabic

Speak up

May 13th 2004
From The Economist print edition

Arabic-speaking spooks are in high demand. But there's little supply

BRITAIN'S domestic security service, MI5, is on a recruitment drive. The home secretary, David Blunkett, announced earlier this year new money for a 50% expansion, meaning around 1,000 new officers. But more cash will not necessarily translate into more spies. The shortage of Arabic students, according to a top spy, is causing problems.

During the cold war, MI5 needed Russian-speakers and not much else. For the war against terrorism, it needs the languages terrorists speak. It has tried recruiting those who speak the necessary languages as mother tongues, but without much success, so it needs people to study them at university. But, says the British Society of Middle East Studies (BRISMES), the study of those languages is “endangered”. Kurdish and Afghan languages (Pashto, for example) are not taught at all, and Arabic and Persian are in decline.

One problem is money. French and German departments teach students who have started at school; those studying Arabic tend to start from scratch, and need intensive tuition. Moreover, the departments are small, and unlikely to bring their universities either glory, or large numbers of lucrative overseas students. Both those factors make them vulnerable.

A second problem is that whereas finding a job as an Arabic-speaking graduate is easy, staying in academia to teach the next generation does not look attractive. “In my department the youngest permanent post-holder is in his early 40s; the average age is 56,” complains Clive Holes, an Arab studies professor at Oxford. Between 1996 and 2003 only 12 British Arabic postgraduates got grants from the Arts and Humanities Research Board, the main funding body. In effect Britain lost its capability to teach Kurdish when postgraduate funding for just one post dried up. Christine Allison, who filled it, has moved to France.

Thirdly, undergraduate Arabic applicants tend to come “overwhelmingly” from fee-paying schools, according to BRISMES. As universities struggle to raise the numbers of state-school students, subjects favoured by the posh and brainy are considered a liability.

So what to do? The Foreign Office is used to training people to speak difficult languages from scratch, with a mixture of tailored tuition and home-stays. Britain's foreign intelligence service, MI6, does the same. But both have suffered from the closure in 1978 of the British government's language school in Lebanon, seen as the best such outfit in the world. “We are losing our edge. The methods used by the Foreign Office do not produce the same result,” complains Leslie McLoughlin, an Exeter-based academic who has been teaching Arabic for more than 40 years.

The armed forces teach “Beaconsfield Arabic” at their language school in that Buckinghamshire town. This ingenious amalgam of different dialects is spoken by no native speakers, but is readily converted into whatever version is needed. But numbers are short: the military resorted to hiring two Exeter university students to work as interpreters in Iraq.

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MI6

Old spooks and new

May 13th 2004
From The Economist print edition

The new top spy is a prime-ministerial crony. Some think that's bad, some don't

A BLURRED 40-year-old photo of a student oarsman is still the most recent available picture of Sir Richard Dearlove, outgoing head of Britain's Secret Intelligence Service (SIS), commonly nicknamed MI6. John Scarlett, a spy-turned-bureaucrat newly named as the next “C” (for “chief”), is rather better known. He forcefully defended Tony Blair's use of intelligence about Saddam Hussein at last year's Hutton Inquiry.

That led many to see him as tainted by his closeness to politicians. Alastair Campbell, the prime minister's then spin doctor, once termed him a “mate”. His appointment prompted a flurry of criticism from spook-watchers. What the service needed now was a return to professional neutrality, they argued. Putting one of Tony's cronies in charge was quite wrong.

Some spooks may agree. Several of them have been quietly but audibly unhappy with the government's overenthusiastic and public use of secret intelligence in the run-up to war. Sir Richard himself had earlier told a lunch for editors that on balance Iraq was a lesser threat than North Korea. He is said to have preferred his deputy, Nigel Inkster, for the top job.

But there are other voices from the shadows too. Inside the “office”, there is a feeling among people at the sharp end that SIS needs more political savvy, to ensure that its products are not misunderstood or—worse—misused. Mr Scarlett's time running the Joint Intelligence Committee, which links the spymasters to the politicians, gives him the best possible understanding of the pitfalls facing his old firm. Having someone on board who knows the opposition backwards is, after all, SIS's stock-in-trade.

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Football

Liverpool's Thai-up

May 13th 2004
From The Economist print edition

Why foreigners want to buy into the most unreliable of British businesses

Get article background

EPA

Liverpool's latest signing?

IF THAKSIN SHINAWATRA, the Thai prime minister, succeeds in buying 30% of Liverpool Football Club, he will be following a well-trodden path. Roman Abramovich, a Russian oil baron, bought Chelsea last year for £140m ($225m) and promptly spent over £110m buying players. Next-door Fulham has belonged since 1997 to Mohamed Al Fayed, the Egyptian owner of Harrods. Around 25% of Manchester United, a quoted company, belongs to two Irish racehorse-owners, another 18% to the boss of an American-football club in Florida. Albert Scardino, American husband of Pearson's chief executive, was briefly chairman of Notts County.

Why do foreigners want to join in the great British sport of hurling wads of fivers down this particular black hole? Some football clubs look like a reasonable investment—Man U made £27m, pre-tax, in its latest half-year—but most don't. To Mr Scardino, a modest local club was like the local paper he used to run in Savannah, Georgia: it offered a place in the community. Likewise to Mr Al Fayed: Fulham wasn't a road to profit but (he hoped, and found himself mistaken) to acceptance. To Mr Abramovich, a football club is a luxury good, and that market is global these days. A slice of Liverpool might win Mr Thaksin popularity at home, where English Premiership football and (illegal) gambling on its results have a huge following.

Mr Thaksin's suggestion that he may use public money, rather than his own, for this purchase, may dim Thai taxpayers' enthusiasm. He already has trouble with the Liverpool fans. The club may want his cash—chief executive Rick Parry has met Mr Thaksin to negotiate a deal (pictured above)—but the fans are swinging behind a rival offer from a Liverpool-born housebuilding tycoon, Steve Morgan. As Mr Al Fayed learned when he sought British citizenship, and Man U's Irishmen did when they quarrelled with the club's manager, Sir Alex Ferguson, last winter, local acceptance does not come easy.

Yet British fans should maybe learn a bit of global give-and-take: second-division Stockport County has just bought 50% of a football club, now called Stockport Tiger Star, in Shenyang, China.

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Race discrimination

Nice work if you can get it

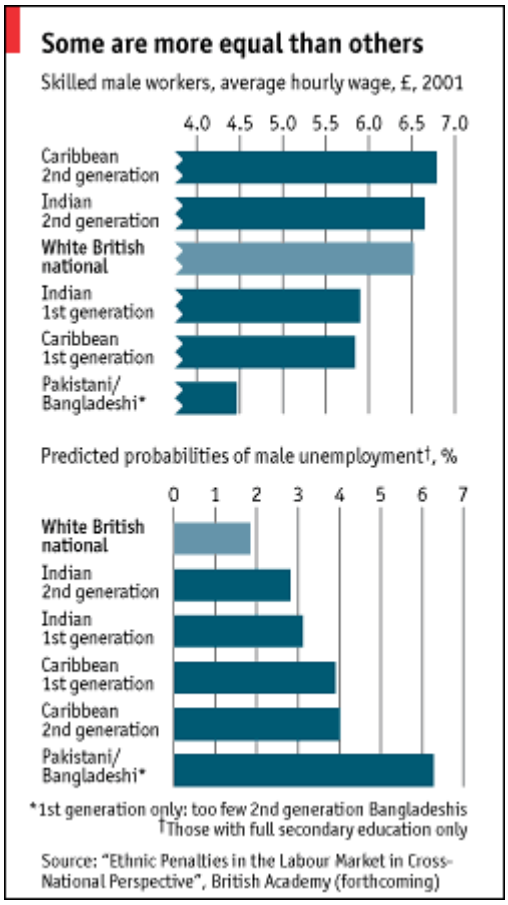
May 13th 2004
From The Economist print edition

Ethnic minorities narrow the salary gap, but not the employment gap

Get article background

THIS week, the government announced the end of a peculiarly British approach to racial justice. For the past 28 years, the Commission for Racial Equality (CRE) has persuaded, prodded and sometimes helped to prosecute employers that fall foul of anti-discrimination laws. By 2006, it will be superseded by a single commission dealing with all kinds of discrimination, from misogyny to homophobia.

The CRE has always reflected the belief that race relations are a matter of getting people to uphold the rules. Outside Northern Ireland, Britain has never had anything like American-style affirmative action policies, where people competing for scarce resources (university places, construction jobs) can be screened for race. That is because there is little sense of righting historical wrongs. "Americans are trying to heal a racial scar, while Britons are dealing with immigrant integration," says Shamit Saggar, who follows the subject at Yale University.



Has the more polite, bureaucratic approach worked? Two Oxford sociologists, Sin Yi Cheung and Anthony Heath, have analysed General Household Surveys from 1991 to 2001. They come up with two findings—one happy, the other dismal.

The happy finding is that British-born ethnic minorities seem to be doing the same kinds of jobs as similarly qualified whites, and earning similar amounts. The children of Afro-Caribbean and Indian immigrants have completely closed the earnings gap with whites, in both professional and blue-collar work. They have overtaken their parents—something that may also be true of the descendants of Pakistanis and Bangladeshis too, although the evidence is too thin to be conclusive.

The bad news is that ethnic minorities are finding it difficult to get jobs in the first place. Worst off are foreign-born Pakistani and Bangladeshi men, who are around three times more likely to suffer unemployment as white men of the same age and level of education. Thanks to the decline of the northern mill towns, Pakistanis are actually worse off than they were in the 1970s. Black men are twice as likely to be out of work at all skill levels (and, most worrying, the second generation is faring just as badly as the first). Even Indians find themselves out of work more than similarly qualified whites.

Why is there an "ethnic penalty" for employment, but not wages? Mr Heath suggests one answer: "It's much easier to detect discrimination once you're hired. When a person is turned down for a job, they rarely know why." The enforcement regime probably plays a part, too. The CRE has more power to right individual wrongs than to investigate funny-looking hiring patterns.

Current plans for the new commission do not suggest anything more ambitious. But mounting evidence of an employment gap may force change. Trevor Phillips, the chair of the CRE, is already advocating what he calls "accelerated integration", in which employers could suspend the normal rules in order to

secure a more diverse workforce. It's an approach that has already been tested in Northern Ireland and is gaining ground among policy wonks on the mainland. So Britain could end up following America, after all.

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Local elections

Battle of Birmingham

May 13th 2004 | BIRMINGHAM
From The Economist print edition

Can the Conservatives win a big city?

CONSERVATIVES feel the same way about Birmingham as the Democrats in America used to feel about the South: it ought to be theirs, but they're not sure how to get it back. The small businesses that Brummies think of as the mainstay of their economy should be a production line for manufacturing Tories. The city's most famous politician, Joseph Chamberlain, converted from Liberalism to Conservatism and used the town hall to launch his best-known campaign. But Labour has now been the largest party on the council for the last 20 years. There is no Conservative MP here, and Tory councillors are largely confined to affluent suburbs (see map).

This could all change on June 10th, when ward boundaries will be shifted and all 120 of Birmingham's council seats will be up for grabs. This kind of electoral bacchanalia hasn't happened in Birmingham since 1982. The Conservatives know that if they are to be in with a chance of winning the next general election, they must establish a presence in the town centres. Their leader, Michael Howard, sensing an opening, came here to launch his party's local government campaign.

Birmingham could be the Tories' best chance of taking control of a big city council. Though Labour has long been Birmingham's biggest party, the council is not a one-party state of the sort found in some cities farther north. Labour currently has 56 councillors to the Tories' 35. The Liberal Democrats are in third, with 24. But the Tories will gain an extra three councillors almost automatically, when the three populous wards they hold in the north of the city divide into four.

The way the electoral battle is shaping up also favours the Conservatives. The Liberal Democrats will concentrate their energetic campaigners on a band of wards across the middle of Birmingham, from Soho in the west to Sheldon in the east. Many of these are red; none of them is blue. This should allow the Conservatives to concentrate on fighting Labour, which will be in the ring with two opponents.

And there is also plenty for Conservatives to attack the Labour-led council on. The Audit Commission, which gives out gold stars and black marks to councils in England and Wales, rated Birmingham “weak” in its last assessment. The council's housing department fared particularly badly. Social services did not do much better: blunders there achieved nationwide fame in March, when they had to apologise for failing to protect a seven-year-old girl placed in their care, who was shot dead while in London with a drug dealer whom social workers mistook for her father.

The city's economy is more neutral territory. The new Bullring shopping centre has been visited by more than 27m shoppers since it opened in September, but is a private development whose success the parties are finding hard to appropriate. There are some impressive public projects in the city centre, but they fly the blue and gold flag of the European Union, and were partly paid for by its regional development fund (whose head, Sir Albert Bore, is also Labour leader on the council). Claiming credit for this bounty might seem to smack of cronyism.

The election of the council is, however, likely to be determined by national rather than local politics. The People's Justice Party, which stands on a platform of self-determination for Kashmir and a state for the

Palestinians, shows how important foreign policy is in parts of the city. And in June many Muslim voters will be thinking of Basra rather than bus shelters.

Here too the Tories are looking good: if more disgruntled Muslims desert Labour for the Lib Dems, as they did in the elections last year, and if the turnout of apathetic Labour voters is low in the marginal wards in the south of the city, the Conservatives will win. Whether that would add up to a new dawn for the party in the cities, and a breeding ground for future Chamberlains, is less clear.

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Scottish Tories

Spring in their step

May 13th 2004 | EDINBURGH
From The Economist print edition

At last, the whisker of a possibility of a Scottish Tory revival

Get article background

WHEN Margaret Thatcher became prime minister in 1979, things turned chilly for the Scottish Conservatives until they were frozen out altogether, losing all seats in 1997. They survived only because proportional representation (which they opposed) gave them 18 seats in the Scottish Parliament (which they also opposed). Now, however, they seem to be basking in unexpected spring warmth. “The party is in the most optimistic mood I can recall for 12 years,” says Murdo Fraser, MSP.

In recent council by-elections, the Tories have gained votes in all contests bar one. Most of the gains have come at the expense of the Liberal Democrats, who have for years been taking Tory votes.

David McLetchie, the Scottish Tory leader, gives the Tory revival south of the border much of the credit. “Michael Howard is a leader who clearly looks like a prime minister. The party looks like it could form a government, so people are starting to pay attention.” Attendance at the party's conference in Dundee on May 14th-15th looks like being a third up on last year.

At the conference, Tories will be debating two important issues. The first is increasing the Scottish Parliament's tax-raising powers. The Tories think the Parliament needs to be given more responsibility for raising the £24 billion it spends, and also hope to rid themselves of their anti-devolution (hence, in many voters' eyes, anti-Scottish) image.

The second is how to exploit perceived Scottish National Party (SNP) weakness over Europe and fishing. The Tories argue that the only way to resolve Scottish fishermen's problems is to scrap the EU's Common Fisheries Policy. Mike Park, chairman of the Scottish White Fish Producers' Association—and a power in the land—is to argue for this idea at the conference. “The SNP position is confused. The Tory message is simple—get us out,” he says.

The Tories are confident that this Euro-scepticism will win votes in the SNP's north-east heartlands, home of the white fish industry. Indeed, with the SNP in disarray (one of its MSPs has been suspended for repeatedly attacking the leadership) and a Labour government in some trouble, politics north of the border is starting to resemble 1978. A year later, the Scottish Tories gained six seats, all from the SNP.

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Sex and chastity

Under-sexed and over here

May 13th 2004
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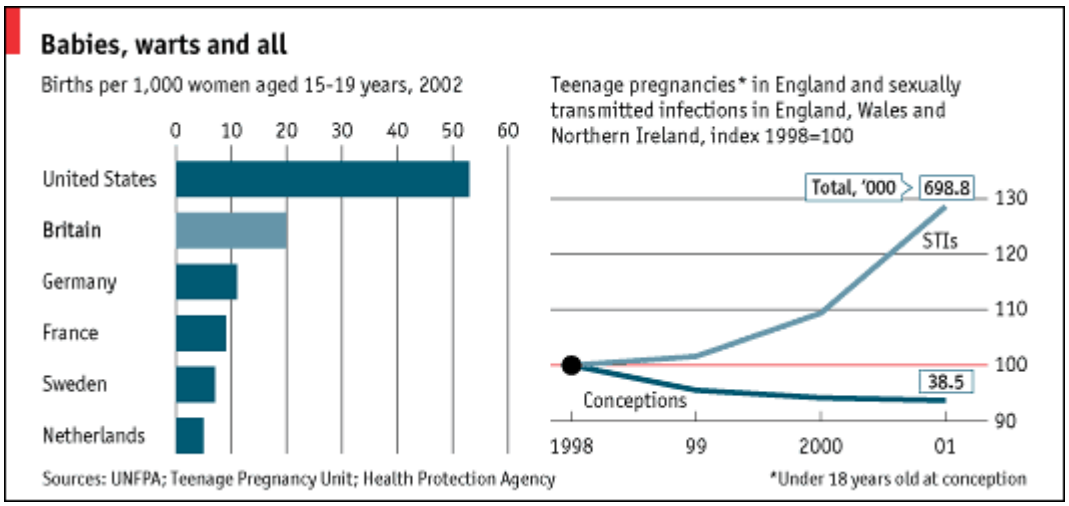
An American plan for Britain's promiscuous teenagers

TEACHING British teenagers sexual abstinence might seem like training a wolf to eat breakfast cereal, but Denny Pattyn, founder of the Silver Ring Thing in America, is giving it a try. Mr Pattyn came over to Britain this week to draw attention to the organisation's British tour in June, when he will be visiting cities with groups of virginal Americans in the hope of persuading teenagers here to take a pledge abstaining from sex before marriage. Those who do will get a silver ring with a biblical inscription, which they then give to their beloved on their wedding day.

Abstinence programmes have so far made little impact in Britain. Though there are some home-grown versions, such as Love for Life in Northern Ireland, the government is not interested in funding them. Sir Liam Donaldson, the Chief Medical Officer, has recommended that there is no evidence that they work, and the government's strategy for teenage sexual health has concentrated instead on teaching how to have sex without reproducing.



On this measure, it has been moderately successful. From 1998, the first year of the teenage pregnancy strategy, to 2001, teenage pregnancies decreased by about 6.4% (see chart). Each local authority now has a teenage pregnancy co-ordinator, who does the opposite of what the job title suggests. The methods imitate programmes in countries like the Netherlands, which has a far lower rate of teenage pregnancy.

Fewer pregnancies probably do not mean less sex, though. The Office for National Statistics says that the proportion of 16-19 year olds who tell researchers they have never had sex fell from 39% to 27% between 1999 and 2001. Another sign that less could in fact mean more comes from statistics on the increase in sexually transmitted infections (STIs) among the population as a whole.

Some see a causal link here. David Paton of Nottingham University Business School reckons that teenagers, armed with more information on safe sex, are having more sex, thus spreading STIs. The government says the apparent increase in infections reflects teenagers being more open about their behaviour, but the coincidence of these two trends is striking.

Abstinence would clearly be the most effective way to slow the spread of STIs, but the kids find it understandably tough to stick to. The majority do not manage to hold out until their wedding night. And

a study by America's Columbia University showed that teenagers who took abstinence pledges were more likely not to use contraception when they broke their vows than those who had never pledged.

Mr Pattyn thinks that Silver Ring wearers are more likely to stick it out than teenagers on other abstinence programmes, because they are not pushed into pledging by their parents. But he also says that just delaying the age of sex for the first time can be counted as success. For those who don't want to have sex, the ring is a good way to deflect peer pressure. The rest will just have to make friends with the chemist.

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Exporting drunkenness

Staggering

May 13th 2004
From The Economist print edition

The Baltic states are the lucky new destination for British stag parties

OFFSHORING—sending businesses to cheaper foreign countries—is a familiar practice in manufacturing, software and call centres. Now low-cost locations are luring a more intimate service industry: stag parties.

These are an odd British rite of passage, mixing practical jokes, drink and sex with results that range from harmless pre-marital jollity to wedding-busting brutish excess. Despite unreliable weather and greasy food, eastern Europe's lax police and cheap booze and floozies give it an edge. Now Tallinn, the Estonian capital, is catching up Prague, previously the hotbed of post-communist carousing. Tom Kenyon, who runs stag party tours in a bunch of east European cities, says annual bookings to Tallinn have tripled since last year, to 1,500.

That reflects the country's nightlife, advanced by post-communist standards. Three brothels are visible from the town-centre offices of the minister of social affairs. Booze cruises by drunken Finns were one of the first holes made in the Iron Curtain during Estonia's occupation by the Soviet Union. Additional entertainments of a boyish sort, such as machine-gun firing with live rounds, are a pull for macho refugees from safety-mad Britain.

But the vomit-laden tide of new business is proving quite a shock in a country where Britain has had a perhaps undeservedly good reputation. Tarmu Tammerk, editor of the country's main daily, *Postimees*, says “Finns just get drunk and that's it but these British stag parties are extremely noisy. Some restaurants won't have them. They misbehave, they break the dishes, make an awful lot of noise, and they are scaring away other customers.”

Mr Kenyon steers his parties towards hotels, bars and restaurants that like that kind of business. “I wouldn't send them to a small family-owned hotel,” he says firmly. And the future is awash with promise. Although the number of flights is now increasing, only one airline flies direct to Tallinn from London. Budget airlines put Prague on the orgiasts' map and one of them, easyJet, is soon to launch a service between London and the Baltics. That will hugely increase business, says Mr Kenyon.

Eve Tarm, publisher of a local tourist guide, the *City Paper*, admits that “some hoteliers are surprised at the behaviour of their British guests.” But it's the price of making her country better known, she says: “Estonia's a kind of nowhere-land in West Europeans' minds. So Estonians think ‘let them discover it and then a larger variety of people will come'.” That will be nice when it happens. In the meantime, the country's top brewery, Saku, is opening a “beer hotel” on Tallinn's waterfront.

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Bagehot

Moral hazard

May 13th 2004
From The Economist print edition

Why things look even worse for Tony Blair than they do for George Bush

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TONY BLAIR has told close colleagues that should he come to believe that he is an electoral liability he will make way for Gordon Brown to succeed him as Labour leader. Plainly, he doesn't think things have yet reached that stage or he wouldn't have said it. But if Labour's approach to next month's European Parliament and local-government elections is any guide, others have already reached that conclusion.

For all the brave talk of a few weeks ago about making the positive case for Europe and being eager to campaign on the government's record, the party's advertising this week has been entirely negative. Its sole aim has been to demonise Michael Howard, the Tory leader, by jogging the memories of voters about the things he got up to as a minister more than a decade ago. Labour strategists cannot for one moment think that whiskery newsreel footage of poll-tax rioters will deflect attention from more recent and infinitely more gruesome images from Iraq. The best they can hope for is that jeering at Mr Howard's past may offer some temporary displacement activity to party workers who would prefer not to dwell on how they feel about their own leader.

It would be hard to exaggerate how disastrous the past two weeks have been for the prime minister. The sickening pictures of the degradation of Iraqi detainees and the damning report of the International Committee of the Red Cross are acutely embarrassing for President Bush, but the damage they do to Mr Blair is of a different order.

The swiftness of the initial military victory apart, just about everything to do with Iraq that could have gone wrong for Mr Blair had already done so. From the failure to secure a second UN resolution, the inability to find any weapons of mass destruction, the intractable security situation and, generally, the unfathomable incompetence that has characterised post-war planning and administration, Iraq has been a series of crumbled beliefs and dashed hopes for the prime minister.

But, through it all, Mr Blair has been able to fall back on his passionately held belief in the moral justification for the war. However bad things might be in Iraq, he has still been able to contrast the vileness of Saddam Hussein with the good intentions and noble mission of the coalition partners.

That distinction still exists. Most people, Iraqis included, can see that there is a world of difference between a regime founded on fear and torture and one that has sworn to root out and punish the moronic abusers who have shamed it. Many will even concede that despite everything that has happened, there is still at least a chance that in a few years' time Iraq will be a better and happier place than it could ever have been if Mr Hussein had been left to his devices. But to many others, the moral case for intervention has been stamped and stained, probably indelibly, by the image of Lynndie England yanking a prostrate, naked Iraqi on a leash.

Most of all, Mr Blair is damaged by what is seen as his complicity with an administration in Washington that many Britons—even some of those who have consistently supported the war—never much cared for and now roundly loathe. It is possible that the depravities in Abu Ghraib were not systematic, although the Red Cross report suggests otherwise. But, as has been widely observed, Donald Rumsfeld's casual disregard for the Geneva conventions may well have fostered the culture of extra-legality that undoubtedly existed. By placing himself in a position that prevents him from uttering so much as a word of criticism of the Bush administration, Mr Blair may actually be helping to feed the growing hostility towards it.

This is the price Mr Blair has paid for being guaranteed the friendly and respectful hearing from Mr Bush by which he sets such store. But what has been clear for some time is that although the “poodle” jibes were always over the top, Mr Blair's relationship with Mr Bush has never extended to any influence over Dick Cheney or Mr Rumsfeld, the hard-faced men who have mostly run the war and whose mistakes have contributed to its bitter aftermath. The truth is that Britain has accepted almost limitless liability for what happens in Iraq, in exchange for very little power over events.

What's the alternative?

Mr Blair is now left in a most peculiar position as far as his own party is concerned. About a third of his MPs were opposed to the war, a third were sceptical but prepared to give the prime minister the benefit of the doubt rather than see him defeated, and the remaining third were true believers. A year on and armed with the benefit of hindsight, there are few even among the last group who are without regret. Yet although there is anger with Mr Blair, there is more sorrow and some sympathy. In addition, there is a certain “we are where we are” stoicism.

The prime minister is also helped by three other factors: the absence of an alternative Iraq policy—not many, even among those who voted against the war, think there is any quick or easy way out; the prospect of a general election this time next year; and the lack of any efficient mechanism for dumping Mr Blair. It is possible that things could look different if the results of next month's elections are shattering for Labour. But the party is already braced for the worst and experience suggests that whatever happens in June will have relatively little bearing on the general election.

As for Mr Blair, he is either formidably resilient or in a state of denial. He now accepts that it will be years rather than months before he is vindicated. But he is quite certain he will be. For the moment, at least, no queue is forming outside the prime minister's door to persuade him that his party really might be better off without him.

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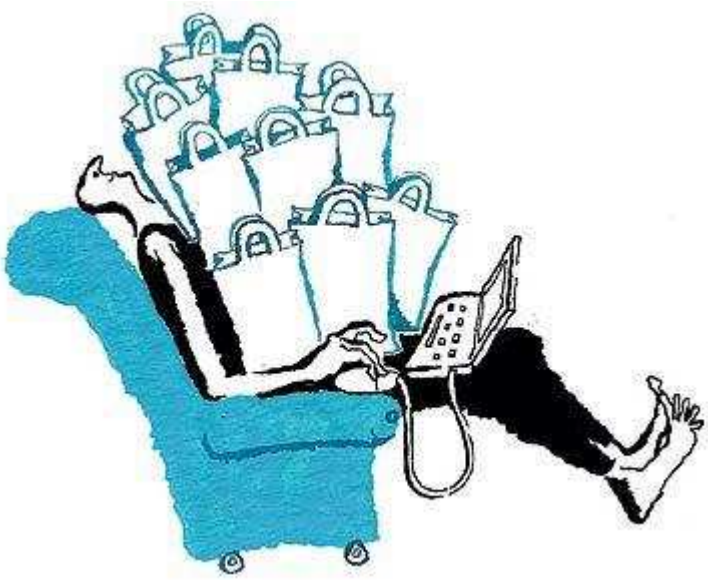
A perfect market

May 13th 2004
From The Economist print edition



E-commerce is coming of age, says Paul Markillie, but not in the way predicted in the bubble years

WHEN the technology bubble burst in 2000, the crazy valuations for online companies vanished with it, and many businesses folded. The survivors plugged on as best they could, encouraged by the growing number of internet users. Now valuations are rising again and some of the dotcoms are making real profits, but the business world has become much more cautious about the internet's potential. The funny thing is that the wild predictions made at the height of the boom—namely, that vast chunks of the world economy would move into cyberspace—are, in one way or another, coming true.

The raw numbers tell only part of the story. According to America's Department of Commerce, online retail sales in the world's biggest market last year rose by 26%, to $55 billion. That sounds a lot of money, but it amounts to only 1.6% of total retail sales. The vast majority of people still buy most things in the good old “bricks-and-mortar” world.

But the commerce department's figures deal with only part of the retail industry. For instance, they exclude online travel services, one of the most successful and fastest-growing sectors of e-commerce. InterActiveCorp (IAC), the owner of expedia.com and hotels.com, alone sold $10 billion-worth of travel last year—and it has plenty of competition, not least from airlines, hotels and car-rental companies, all of which increasingly sell online.

Nor do the figures take in things like financial services, ticket-sales agencies, pornography (a $2 billion business in America last year, according to *Adult Video News*, a trade magazine), online dating and a host of other activities, from tracing ancestors to gambling (worth perhaps $6 billion worldwide). They also leave out purchases in grey markets, such as the online pharmacies that are thought to be responsible for a good proportion of the $700m that Americans spent last year on buying cut-price prescription drugs from across the border in Canada.

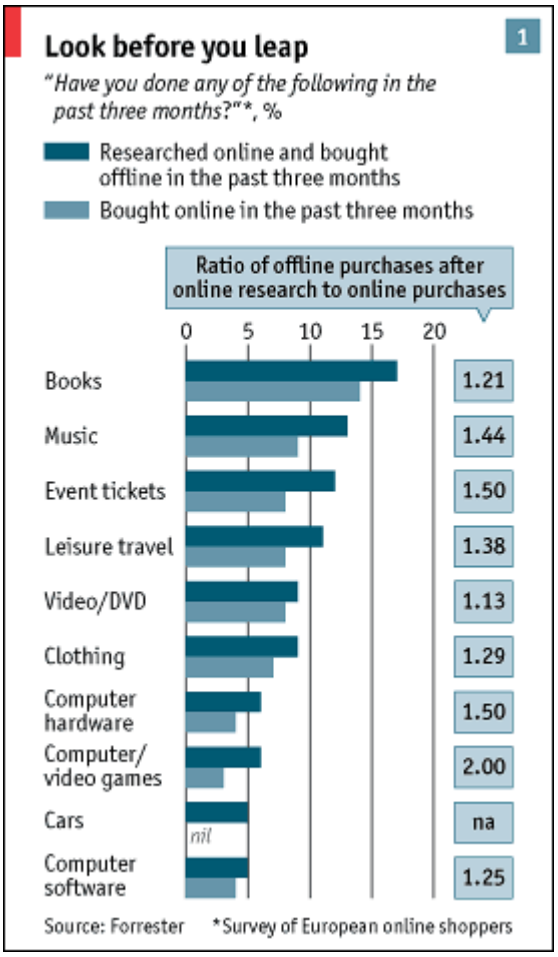
Tip of the iceberg

And there is more. The commerce department's figures include the fees earned by internet auction sites, but not the value of goods that are sold: an astonishing $24 billion-worth of trade was done last year on

eBay, the biggest online auctioneer. Nor, by definition, do they include the billions of dollars-worth of goods bought and sold by businesses connecting to each other over the internet. Some of these B2B services are proprietary; for example, Wal-Mart tells its suppliers that they must use its own system if they want to be part of its annual turnover of $250 billion.

So e-commerce is already very big, and it is going to get much bigger. But the actual value of transactions currently concluded online is dwarfed by the extraordinary influence the internet is exerting over purchases carried out in the offline world. That influence is becoming an integral part of e-commerce.

To start with, the internet is profoundly changing consumer behaviour. One in five customers walking into a Sears department store in America to buy an electrical appliance will have researched their purchase online—and most will know down to a dime what they intend to pay. More surprisingly, three out of four Americans start shopping for new cars online, even though most end up buying them from traditional dealers. The difference is that these customers come to the showroom armed with information about the car and the best available deals. Sometimes they even have computer print-outs identifying the particular vehicle from the dealer's stock that they want to buy.



Half of the 60m consumers in Europe who have an internet connection bought products offline after having investigated prices and details online, according to a study by Forrester, a research consultancy (see chart 1). Different countries have different habits. In Italy and Spain, for instance, people are twice as likely to buy offline as online after researching on the internet. But in Britain and Germany, the two most developed internet markets, the numbers are evenly split. Forrester says that people begin to shop online for simple, predictable products, such as DVDs, and then graduate to more complex items. Used-car sales are now one of the biggest online growth areas in America.

People seem to enjoy shopping on the internet, if high customer-satisfaction scores are any guide. Websites are doing ever more and cleverer things to serve and entertain their customers, and seem set to take a much bigger share of people's overall spending in the future.

Why websites matter

This has enormous implications for business. A company that neglects its website may be committing commercial suicide. A website is increasingly becoming the gateway to a company's brand, products and services—even if the firm does not sell online. A useless website suggests a useless company, and a rival is only a mouse-click away. But even the coolest website will be lost in cyberspace if people cannot find it, so companies have to ensure that they appear high up in internet search results.

For many users, a search site is now their point of entry to the internet. The best-known search engine has already entered the lexicon: people say they have “Googled” a company, a product or their plumber. The search business has also developed one of the most effective forms of advertising on the internet. And it is already the best way to reach some consumers: teenagers and young men spend more time online than watching television. All this means that search is turning into the internet's next big battleground as Google defends itself against challenges from Yahoo! and Microsoft.

The other way to get noticed online is to offer goods and services through one of the big sites that already get a lot of traffic. Ebay, Yahoo! and Amazon are becoming huge trading platforms for other companies. But to take part, a company's products have to stand up to intense price competition. People check online prices, compare them with those in their local high street and may well take a peek at what customers in other countries are paying. Even if websites are prevented from shipping their goods abroad, there are plenty of web-based entrepreneurs ready to oblige.

What is going on here is arbitrage between different sales channels, says Mohanbir Sawhney, professor of technology at the Kellogg School of Management in Chicago. For instance, someone might use the internet to research digital cameras, but visit a photographic shop for a hands-on demonstration. “I'll think about it,” they will tell the sales assistant. Back home, they will use a search engine to find the lowest price and buy online. In this way, consumers are “deconstructing the purchasing process”, says Professor Sawhney. They are unbundling product information from the transaction itself.

All about me

It is not only price transparency that makes internet consumers so powerful; it is also the way the net makes it easy for them to be fickle. If they do not like a website, they swiftly move on. “The web is the most selfish environment in the world,” says Daniel Rosensweig, chief operating officer of Yahoo! “People want to use the internet whenever they want, how they want and for whatever they want.”

Yahoo! is not alone in defining its strategy as working out what its customers (260m unique users every month) are looking for, and then trying to give it to them. The first thing they want is to become better informed about products and prices. “We operate our business on that belief,” says Jeff Bezos, Amazon's chief executive. Amazon became famous for books, but long ago branched out into selling lots of other things too; among its latest ventures are health products, jewellery and gourmet food. Apart from cheap and bulky items such as garden rakes, Mr Bezos thinks he can sell most things. And so do the millions of people who use eBay.

And yet nobody thinks real shops are finished, especially those operating in niche markets. Many bricks-and-mortar bookshops still make a good living, as do flea markets. But many record shops and travel agents could be in for a tougher time. Erik Blachford, the head of IAC's travel side and boss of Expedia, the biggest internet travel agent, thinks online travel bookings in America could quickly move from 20% of the market to more than half. Mr Bezos reckons online retailers might capture 10-15% of retail sales over the next decade. That would represent a massive shift in spending.

How will traditional shops respond? Michael Dell, the founder of Dell, which leads the personal-computer market by selling direct to the customer, has long thought many shops will turn into showrooms. There are already signs of change on the high street. The latest Apple and Sony stores are designed to display products, in the full expectation that many people will buy online. To some extent, the online and offline worlds may merge. Multi-channel selling could involve a combination of traditional shops, a printed catalogue, a home-shopping channel on TV, a phone-in order service and an e-commerce-enabled website. But often it is likely to be the website where customers will be encouraged to place their orders.

One of the biggest commercial advantages of the internet is a lowering of transaction costs, which usually translates directly into lower prices for the consumer. So, if the lowest prices can be found on the internet and people like the service they get, why would they buy anywhere else?

One reason may be convenience; another, concern about fraud, which poses the biggest threat to online

trade. But as long as the internet continues to deliver price and product information quickly, cheaply and securely, e-commerce will continue to grow. Increasingly, companies will have to assume that customers will know exactly where to look for the best buy. This market has the potential to become as perfect as it gets.

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Santa's helpers

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Retailers are the top performers online

FOR retailers, the two months before Christmas are the busiest time of the year. The same is true for e-tailers, who enjoyed an exceptionally good holiday season last year. Lots of records were broken: Amazon, for example, took more than 2m orders worldwide in a single day. What is intriguing, however, is not so much that the online traders increased their share of spending (the dotcom community still takes rapid growth in its stride) but that consumers are changing their behaviour.

In November and December 2003, Americans spent $18.5 billion online (excluding travel), 35% more than they did in the same two months in 2002, according to a joint survey carried out by Goldman Sachs, Harris Interactive and Nielsen//NetRatings. The popular perception is that online retail sales rely heavily on gadgets, mostly bought by young men. Not so. Over the holiday period, the most popular category was clothing, up by 40% to $3.7 billion, followed by toys, video games and consumer electronics, which grew little in value because of falling prices (see chart 2).

The overall growth, says the report, was fuelled by the rising number of high-speed broadband links, which now connect 50m American homes to the web. This makes online shopping faster and more convenient. It was a similar story in those countries in Europe and Asia where internet connections are becoming quicker.

Spending patterns on the internet are also getting closer to those on the high street. For instance, in Britain last year women spent more online than men: £495 ($809) against £470 per person. The growth in spending by female online shoppers was 71%, six times faster than that for men, according to Verdict, a retail consultancy. This helped to boost Britain's total online market by 36% to almost £5 billion last year, which meant it grew nearly ten times faster than total retail spending.

Older people, too, are using the internet more to shop. “The over-55s have flooded online over the past year, and they are spending more than any other age group, at £527 per head,” says Verdict. Groceries, electrical goods and home-improvement products are particularly popular with the older set. But for all age groups, convenience seems to have overtaken price as the main reason for shopping online.

Much of the online shopping is heavily concentrated on a few sites. In January 2004, 83.5m Americans, or just over half of the country's internet users, visited either eBay or Amazon, making these sites among the most frequently visited retail outlets in the country, both online and offline, according to comScore Networks, a technology consultancy. Search engines have also generated sales on a huge scale. Sites such as Google, Yahoo!, MSN and AOL are used increasingly to find and buy products. Search sites now

compare prices from rival retailers for many products.

Sell it cheap

How does Seattle-based Amazon, the leading online retailer, cope with such price transparency? The first part of the answer is simple, says Mr Bezos: “The approach we take is actually to have low prices.” The second is to accept that there is transparency. So if one of the big retailers who now also sell through Amazon, such as Circuit City or J&R, manages to clinch a better deal with one of their suppliers and offer a lower price, Amazon has to reduce its own price, lose sales or keep its fingers crossed that it will win the order for reasons other than price.

Pricing on the internet may well become totally transparent, says Kellogg's Mohanbir Sawhney; but the notion of value remains opaque, and this is where online merchants can compete—even with different prices. The “value proposition” offered by a merchant can mean different things. People might simply like one trader better than another and so be prepared to pay a little more; they might be placing multiple orders and can save money by taking advantage of a free-shipping deal; the site could have recommended something to them based on their previous buying or browsing habits; or they stumbled on something they did not know about and found irresistible.

Amazon's business model is built on five fundamentals which it thinks will not change: low prices; a big selection; availability; convenience; and good information about products. “We are not going to wake up ten years from now and find people saying: ‘This is all well and good, but I wish the prices were a little higher',” says Mr Bezos.

In its efforts to become “Earth's most customer-centric company”, Amazon is using the falling price of computer power to provide shoppers with new experiences. One example is its “Search Inside the Book” feature, introduced last autumn, which allows customers to search the entire text of more than 120,000 books. The results can be displayed as a preview of a page of the book. It is the online equivalent of being able to browse pages, as people do in real bookshops.

Even with cheaper computing, this is an expensive technological bet, but Amazon says it is already encouraging people to buy more books. In 2003, Amazon was profitable for its first full year, with a net income of $35m, helped by a currency gain. Net sales were up 34% to $5.3 billion. Amazon does not publish a detailed breakdown of its sales figures, but its “media” sales (mostly books, music and DVDs) accounted for $4 billion, and electronics and general merchandise most of the remainder. Mr Bezos expects that in time consumer electronics will overtake media as the company's biggest category.

Another thing that helps profits is rigorous cost-cutting. To do this, Amazon employs the Toyota principle—reducing defects and problems in its order process as early as possible. One of Amazon's main quality measurements is contacts per unit ordered. Every time an employee has to intervene in the automatic process, perhaps to redirect something delivered to the wrong address, costs go up. By keeping this measurement as low as possible, Amazon not only reduces its costs but also boosts its customer-satisfaction ratings.

Feel the quality

E-tailers already score very well with consumers, according to the American Customer Satisfaction Index (ACSI). This is a closely watched measure produced by the University of Michigan in association with other groups. The report for the holiday period in the last quarter of 2003 showed an aggregate score for e-commerce of 80.8 (out of 100 possible points), a 4% rise on a year earlier. The national average of consumer satisfaction with all industries is 75. E-tailers earn the highest marks with an average of 84. Amazon.com leads the pack with 88, which the report says is “about as close to matching the consumer ideal as any company has come in the ten-year history of the ACSI”.

A high customer-satisfaction score, Ken Seiff thinks, is one reason why his company survived the dotcom crash when many other online clothing firms perished. Mr Seiff is the head of Bluefly, which sells discounted designer clothing. Based in the heart of New York's garment district, he set up the company in 1998 to offer a way of buying cut-price branded clothing that did not involve rummaging through racks of jumble, as in traditional outlet stores. Backed by George Soros, an international financier, Bluefly is now listed on the Nasdaq exchange, and in February posted its first-ever quarterly profit.

Bluefly's site makes strong use of design themes and enables customers to zoom in to examine clothes and accessories. It also provides some of the services associated with classy boutiques, such as exclusive offers and previews. The idea, says Mr Seiff, is to offer a high-quality shopping experience, which in turn helps his business to secure a better selection of designer goods. And just as brand owners like to separate their end-of-line sales from their latest collections, Bluefly last autumn cleared out its old stock through a different sales medium: it opened a temporary boutique in a real building in New York.

At around 4%, clothing sales online still represent a small proportion of the total, but the share is growing. “Online will never be the largest sales channel,” says Mr Seiff. But, he adds, it will be one of the best-performing, and will be very important in some areas. For instance, teenage consumers are big buyers of clothing online, and their tastes in turn influence mainstream fashion.

The top sites for buying clothes online in America last Christmas were those run by eBay, Lands' End and J.C. Penney. That might seem odd. After all, eBay is seen mainly as an auction site where people sell off their old stuff; Lands' End is a catalogue company (bought by Sears, Roebuck in 2002 for $1.9 billion); and J.C. Penney, like Sears, is an old-fashioned department-store chain.

Back to the shop

Yet although eBay may have started out as an online auctioneer, it now hosts virtual “shop fronts” for some 150,000 stores worldwide. Its sales of clothing and accessories run to more than $1 billion. Lands' End, for its part, has been helped by its strong brand and easy transition to internet selling. It was already a highly successful catalogue company before it went online as early as 1995. Its clothing is now also stocked in Sears's bricks-and-mortar stores. What seems to attract internet shoppers to the sites run by J.C. Penney and Sears is a combination of their known brand values and the fact that they do have shops—hundreds of them.

Lots of consumers clearly see useful connections between the online and offline worlds. Many of the big retailers with websites, such as Circuit City and Sears, offer the option of picking up the goods in their shops. This may seem old-fashioned, but it is surprisingly popular. That could be because people can't or don't want to wait for a delivery van to show up, or they are in a hurry, or they don't want to bother with

a salesperson, or they know they can return what they buy if it goes wrong, or they just want to save on the delivery charge, especially if it is something heavy. At Sears, 40% of online sales (excluding garments) are now picked up in store.

The ability of established retailers to fulfil their orders is a crucial factor. Tesco, Britain's largest supermarket chain, was able to take the lead in online groceries by devising a fairly simple system: goods ordered over the internet are picked from the shelves of the nearest supermarket and delivered to homes within set time slots. Rival online grocers, such as the late Webvan in California, which went for an elaborate and expensive central-warehouse system, found they could not make it pay.

As Verdict says, it should be no surprise that many of the most successful online retailers already have a strong home-delivery operation. Sears, for one, distributed its first general catalogue for home-delivery sales in 1894. Yet for a general retailer, the transition to the internet is by no means easy, says Bill Bass, who joined Sears from Lands' End to help run its online businesses. For a start, inventory systems in hundreds of stores had to be changed so that stock positions could be checked instantly, instead of calculated at the end of the trading day, to avoid disappointing online customers who wanted to pick their purchase up in store.

Lands' End also provides a good example of how technological development and increasingly clever mathematics are bringing new services to the internet. The company now offers a system for custom-made clothes, a sort of Savile Row by mouse-click. Some of the original data for this, says Mr Bass, were gained from inviting groups of customers to have their bodies scanned. Now customers simply answer some straightforward questions, and the Lands' End algorithm works out their perfect fit for them. It learns as it goes along; for example, it now allows for the fact that customers are apt to understate certain body measurements.

After web retailers, the next best group at keeping their customers happy are online auction houses, with an average satisfaction score of 78 (though eBay, which dominates this business, gets an impressive 84). Online travel agents follow at 77. “Travel clearly has room for improvement,” says Larry Freed, the boss of ForeSee Results, which co-sponsors the customer-satisfaction index. “All the sites do roughly the same thing roughly the same way, and there is no clear consumer preference among them.” But the online travel industry is working hard to change that.

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Click to fly

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Within a decade, most travel bookings are likely to move online

Far and wide 4

Top-performing online travel firms*

Travel agency sites	Airline sites
Expedia (US)	Continental (US)
Travelocity (US)	Northwest (US)
Orbitz (US)	America West (US)
Cheaptickets (US)	American Airlines (US)
Ebookers (Britain)	Air France (France)
Wideroe (Norway)	Qantas (Australia)
Opodo (Britain)	Virgin Atlantic (Britain)
Lastminute (Britain)	British Airways (Britain)
Travelocity (Britain)	EasyJet (Britain)
Bridge the World (Britain)	British Midland (Britain)

Car rental	Hotel
Hertz (Britain)	Hilton (US)
Avis (US)	Marriott (US)
Budget (US)	Fairmont (Canada)
Europcar (Britain)	Accor Hotels (France)
Avis (Britain)	Hyatt (US)
Auto Europe (US)	Le Meridien (Britain)
Dollar (US)	Wyndham (US)
Enterprise (US)	Best Western (US)
Alamo (Britain)	Adams Mark (US)
Holiday Autos (Britain)	Four Seasons (US)

*Ranked during October and December 2003 according to various measures, such as site presentation and booking procedures
Source: Shelley Taylor Associates

INSIDE an office block in downtown Chicago, two large rooms next to one another look a little like NASA's mission control. People sit at computers, facing a wall of large screens with constantly changing information. This is the heart of Orbitz, one of the big online travel agencies. Jeffrey Katz, the company's chief executive, says there is a simple reason why more and more people are using the internet to make their travel arrangements: “It's a better way to do it.”

But Orbitz, which was founded by a group of big airlines, and its rivals have to make it better still. Some in the industry think that strong competition and negligible buyer loyalty will cause a big shake-out soon. Some of the smaller companies have already been snapped up. In the past year America's Hotwire, which specialises in discount hotel accommodation, was bought by Barry Diller's IAC; Travelbag, a British long-haul travel specialist, by ebookers; and Online Travel by Britain's Lastminute.

Travel makes up the biggest chunk of business-to-consumer e-commerce, accounting for about one-third of online consumer spending. Last year 35m Americans bought travel online, a 17% increase on 2002, according to the PhoCusWright Consumer Travel Trends Survey. The survey found that nearly two-thirds of those travellers were happy to buy personal travel either from online agencies or directly from the websites of travel firms, and often used both for different parts of the same trip. The vast majority of

customers would consult at least one online travel agency and the website of one supplier before purchasing anything online. Many more people would investigate their travel options online but then book offline.

Internet travel agents need to entice those browsing actually to book their trips with them, and to get them to buy more of their total travel needs from just one site. One way of doing this is to develop “dynamic packaging”. This allows customers to pick all the different elements of their trip from the site, including flights, hotels, car hire, local tours and even tickets to the theatre or sporting events.

In the offline world, such packages have long been put together by tour operators in brochures displayed by travel agents. Such holidays have enjoyed huge popularity, especially with northern Europeans looking for a couple of weeks in the sun. One of the best-loved destinations used to be the Costa Brava, a stretch of coast in north-eastern Spain where package tours were pioneered in the 1950s. But for this summer, First Choice, one of Britain's main tour operators, has dropped the area from its brochure.

Many holidaymakers now expect better-quality hotels, less crowded beaches and more activities than the Costa Brava can offer. The growth of low-cost airlines and a host of online travel services have made it easier and more attractive for them to book their own flights and accommodation. “People like the ability to see everything a travel agent can, and put together their own holidays,” says Robert Booth, who runs the British site of America's Travelocity. They also, he adds, want their bookings to be safe, their money secure and any problems promptly dealt with. If online companies can do all of these things, then people will return and spend more money.

What makes a successful travel package comes back to the question of value. It could be the convenience of buying everything in one place, but it could also be the satisfaction of getting a bargain. In packaged deals, the price of the individual components is often opaque. If travellers check the rates of the airlines, hotels and car-hire firms involved, they may sometimes find that, if bought individually, the parts would cost more than the package. This is because packages involve deals between suppliers and travel agents, such as promoting one particular hotel or airline in return for a rate discounted below the lowest advertised price.

The lure of dynamic packaging

Tour operators have been packaging their trips this way for decades. Getting dynamic packaging to work well online for individual consumers is not so straightforward, but the rewards for companies that pull it off could be rich indeed. At present, in America some 20% of travel is bought online. But many in the industry think that travel could become the first big industry with the majority of its sales online, and that the proportion could reach 50-70% within a decade. Europe is expected to follow the same pattern, but with a delay of about three years.

If these forecasts prove accurate, they will lead to huge changes in the travel business. Dinesh Dhamija, the boss of British-based ebookers, predicts that the two largest holiday travel companies in Europe—Thomas Cook and TUI—will be replaced as market leaders by internet travel companies within five to seven years. Expedia's Mr Blachford is convinced that eventually just about every travel transaction will involve some element of online booking.

The first part of selling travel on the internet was the simple bit, he says. Airlines, hotels and car-rental companies were all using computerised reservation systems already, operated by travel agents or telephone-sales reps. Moving these on to the web did not involve a very big step. After the global slump in travel following the terrorist attacks on September 11th 2001, travel companies were keen to get what business they could from the online agents. But as travel picked up again, some companies have become less willing to pay such agents lucrative commissions for bookings that could be made on their own websites. InterContinental Hotels, which also owns the Holiday Inn and Crowne Plaza chains, has worked harder than most to try to shift bookings to its own sites, not least by guaranteeing that they will offer the best room rates on the internet.

Such moves not only increase competition, but also complicate things for online agents trying to package trips. Clicking to buy a return flight from London to Athens, for instance, is straightforward enough. But a fly-drive holiday from London to Los Angeles for a family of four, with various hotels, car rental, Disneyland tickets and a return via San Francisco, may require help from a real person. Just as with Amazon's contacts-per-unit measure, the more human intervention a travel booking requires, the higher the cost.

Yet the internet still offers advantages. Having used a website to plan a holiday, a customer is likely to have a fairly good idea of what he wants by the time he makes that phone call. This means an online agent's telephone staff can handle more customers than a traditional travel agent, says Mr Dhamija. They can also finalise bookings faster than a high-street agency, because they are spared the sort of customers who come in and say: “We were thinking about going to somewhere like America for a holiday and wondered what was on offer.”

Business class, please

Most of the big online travel agents are now also chasing the market for business travel. According to an industry rule of thumb, about 60% of trips are for leisure and 40% for business; but when it comes to expenditure, the ratio is reversed. Many small companies already deal directly with online agents, but for bigger companies booking business travel is a lot more complex than leisure travel, says Mr Blachford. To increase its expertise in the sector, Seattle-based Expedia has been buying companies that specialise in managing business travel.

Business travel is governed by the budgets and rules set by corporate travel departments (such as who gets to fly business class, and in what circumstances), and by discounts negotiated with particular travel suppliers. In order to win a big corporate account, an online agent may have to provide an almost bespoke service, which might include an individually tailored web page for a firm's employees to log into. Business travellers often demand flexibility, so changing flights and other arrangements has to be easy. This means that online agents may still have to provide help at the end of a telephone.

Nevertheless, with their lower transaction costs, online agents expect to be able to offer cheaper business travel than many offline agents. Some also provide additional services that could be useful for harassed travellers of any kind, business or leisure. For instance, Orbitz employs former air-traffic controllers in its operations centre to keep an eye on potential problems. This means travellers can be alerted to flight delays by e-mail or mobile phone before they set off for the airport.

If they have the cash, of course, they can use the internet to bypass delays altogether, by logging into eBay and buying themselves an executive jet.

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At the drop of a hammer

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Online auctions have been a runaway success

BY SEVERAL measures, eBay is one of the world's fastest-growing businesses. Profitable right from its creation in 1995, the company, based in San Jose, California, now dominates online auctions. Yet what eBay will become in another decade is impossible to predict, not least because some of the things now being traded on it have surprised even its own management. Used cars, for one thing, were thought to be unsuitable: who would want to buy, sight unseen, a secondhand car from a stranger in an internet auction? Yet this year eBay Motors is expected to sell more than $8 billion-worth of vehicles and parts, making it the company's most valuable category of business. Not long ago it was Beanie Babies.

Early entry and rapid growth gave eBay a network advantage. Networks are akin to a snowball rolling down a hill, gathering up ever more snow as it gets bigger. The more sellers eBay attracts, the more buyers turn to it, and the more buyers it gets, the more useful it becomes to sellers. No one has been able to catch eBay, not even Microsoft when it tried to enter the internet-auction business. In the past five years, eBay's net revenue has grown at a compound annual rate of around 80%, and is expected to reach $3 billion this year. Last year's net profits were $442m.

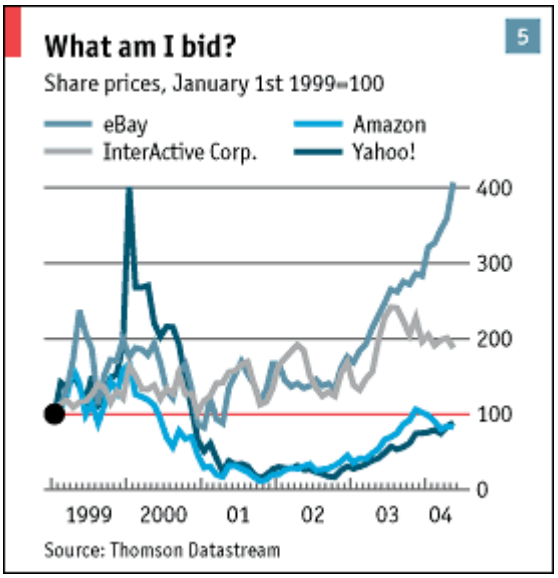
And still the business is picking up speed. With more than 100m registered users worldwide, half the company's revenue will soon come from websites based outside America. Some of these are growing faster than eBay has done in America. Its Chinese site, known as EachNet, took four years to attract 2.4m users, but the number almost doubled in the last six months of 2003. EachNet is now China's biggest e-commerce site.

Meg Whitman, the firm's chief executive, describes eBay as “one part company, one part town-hall meeting and one part entertainment”. The company's strategy is to build a global trading platform that operates at the beginning and the end of the typical bell-curve of a product's life. The bump in the middle, where market pricing works efficiently, is left to conventional retail channels. Where eBay comes

into its own is at either side of the bump.

For instance, when a successful new product is launched, demand for it may be so high that it becomes scarce, so it can be auctioned for more than the recommended price. Then pricing stabilises and high-street (or online) retailing takes over. But as the product ages, it starts having to be discounted to clear out the stock, presenting another auction opportunity. And once its first owner has finished with it, a used market of uncertain values emerges.

The potential in buying and selling goods at either end of the bell curve is enormous, says Rajiv Dutta, eBay's chief financial officer: “We are just scratching the surface.” Compared with ordinary retailing, it also offers another huge advantage for eBay: the company itself does not carry any stock. It simply matches buyers with sellers, who do the packing and posting.



With locally based sites in 28 countries, either fully or partially owned, the service can be tailored to local needs. In France, for instance, eBay conducts wine sales, whereas in South Korea its service is used to sell a lot of *kimchi* (fermented cabbage). And the shop is open round the clock—which is just as well, because many users like to place their bids on a Sunday. In Latin America, where home computers are still relatively rare, eBay's busiest periods are Monday to Friday, 9am to 5pm.

What Ms Whitman means by “town-hall meeting” is eBay listening, responding to and policing its “community” of users. For example, when eBayers started to sell used cars to one another, the company quickly had to develop extra online services to help them do so and to make sure that the vehicles on offer were as described. Otherwise a competitor might have bagged the used-car business—and possibly other bits of eBay too.

Everyone can play

Happy bidders and sellers are crucial to eBay's continued success, so the company is constantly trying to improve its “trading experience”. This means buyers and sellers (all of whom have to be registered) need to find something as close as possible to an honest, open market, or they might not come back. In its simplest form, the system works like this:

•**Buying**. Anything from a Learjet to a lollipop can be found on eBay. A buyer who wants a particular item enters the maximum amount he is prepared to pay. This remains a secret to other bidders while eBay's computers monitor the bidding. Higher offers are accepted until the end of the auction, typically after seven days.

Bidders concerned about the reliability of a seller can see how he has been rated by other buyers, and read comments left by people who have done business with him before. Once a bid has been won, the two sides contact each other, the buyer pays and the seller ships the goods. The terms of the transaction, including shipping costs, are usually listed with the auction. In 2002, eBay spent $1.5 billion to buy PayPal, an online-payments company which now has 45m account holders.

•**Selling**. The details of an item to be sold are completed online and a digital photo is added if required. The seller sets his opening price and perhaps a reserve price, and the length of the auction. Bidding then commences. Whereas bidders get to see just the current highest offer and the number of previous bids, only the seller can see the value of all the individual bids submitted. If a would-be buyer is outbid, he can come back with a higher offer. The seller can check the reputation of a buyer, and if necessary reject his bid. Payment can be made by credit card, provided the seller has a PayPal account.

“If people were not inherently good and trustworthy, this would not work,” says Simon Rothman, who runs eBay Motors. Nevertheless, eBay has to watch out for fraudsters and pranksters. Newly registered users and people who register a new trading name are identified by eBay's computers as lacking a trading history and may be asked to get in touch by e-mail to verify their identity before placing bids. Auctions are also monitored to weed out potential troublemakers and criminals. Even so, buyers and sellers can end up in dispute. But the company has mechanisms for resolving these, and for money-back guarantees to be offered.

EBay also operates “virtual stores” for some of its users. It now has hundreds of thousands of people around the world making a full-time living from buying and selling things on its site or earning a second income. One example is Steve Weinberg from El Dorado Hills, California. He sells new and refurbished consumer electronics, such as digital cameras, music players and DVD recorders. He started his business in 1999 as a hobby, but now works on it full-time. His sales of over $25,000 a month qualify him for additional benefits as an eBay “power seller”.

Gail Wall, a single mother from Billingham in Britain, has gone part-time in her main job to give her more time to nurture her ceramics businesses on eBay. Her goods are mostly bought from car-boot sales. She thinks she will be able to afford to give up the main job later this year.

There are also businesses that have been created specifically to offer goods and services to people trading on eBay. One of them is AuctionDrop, which provides drop-off points in the San Francisco Bay area for things to be auctioned online. The company takes a cut of the proceeds. Late last year, Randy Adams, AuctionDrop's founder, raised $6.6m in venture-capital funding to expand his business.

EBay has performed a rare feat by both achieving huge commercial success and providing a lot of entertainment for its customers. But when it comes to offering fun on the web, it has plenty of competitors.

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A market too far

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Why some business-to-business exchanges have been slow to take off

BEFORE the dotcom bubble popped, the really big money in e-commerce was expected to be in business-to-business (B2B) websites, especially in online auctions. By various estimates, 1,000-1,500 companies had been set up and were waiting to crack this big new market. The idea was that they would provide the infrastructure other businesses would use to trade among themselves and procure goods and services.

It did not work out like that. For one thing, companies were not particularly willing to sift through tenders from lots of suppliers they had never dealt with before. Most of them prefer to build stable longer-term relations with a limited number of suppliers. And instead of paying middlemen to facilitate B2B trade, many firms simply started dealing directly with one another electronically, replacing letters and faxes with e-mails and other digital documentation. Some companies also turned to more general online exchanges, including eBay.

But not all the early B2B exchanges floundered. In some large industries, such as metals, chemicals and cars, they continue in various forms. One is the WorldWide Retail Exchange, which was founded in 2000 by a group of retailers including J.C. Penney, Gap, Auchan, Marks & Spencer and Tesco. It now has more than 60 members. Fabiano Aguilar, a Paris-based director of the exchange, says that its members have, so far, saved more than $1 billion. He acknowledges that eBay is helping popularise the concept of bidding for goods and services. “There's a perfect price out there and as a buyer, I want to get it,” he adds.

His exchange, which is run as an independent company, offers firms a variety of services, including standardised processes for tendering and bidding. Most of the savings have come from companies finding more efficient suppliers and keener prices, says Mr Aguilar. Eventually, however, he expects far bigger savings to be made from making supply chains more effective. The exchange is offering increasingly sophisticated services, such as auctions that factor in transportation costs, different currencies and even the notional cost of having to build a new relationship after switching suppliers.

The process is also faster and more transparent than before it moved online. Placing new contracts would often involve weeks of haggling and many meetings between a company and its suppliers. Sometimes the negotiations would become rather adversarial. At other times the relationship would be a little too cosy, with backhanders in cash or kind offered to clinch an order. The B2B side of the auction business avoids such excesses. After a difficult start, it now seems set to grow.

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Virtual fun

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There are plenty of ways to amuse yourself online

E-COMMERCE companies like to sum up in a single phrase what their business is about. “Making inefficient markets efficient,” is how eBay's management explains what it does. “We try to figure out what customers want and then give it to them,” says Amazon's Jeff Bezos. Reed Hastings's one-liner is more curious: “We're a goose-bump-delivery device.”

Having got stung with a $40 late-payment charge for failing to return a rented DVD on time, Mr Hastings decided there had to be an easier way to rent movies. In 1999 he started an online subscription service called Netflix. The company, based in Los Gatos, California, now has 1.5m subscribers who order DVDs over the internet and receive and return them through the post. This might not seem very innovative, but it has been extraordinarily successful. Netflix went public in 2002. In 2003 it had revenues of $272m, up 78% on the year before, and made its first profit, of $6.5m. If the business keeps this up, revenues will hit $1 billion in 2006.

Netflix faces a host of competitors, including high-street giants such as Blockbuster, which has seen a decline in DVD rentals. So how does the company differentiate itself from the rest? That is where the goose-bumps come in. Movies are about emotions as much as entertainment. Seeing a good movie can make someone's day. People like to tell others about it, and the word spreads.

What Netflix does is to make this happen easily and cheaply. For $19.95 a month you can rent up to three DVDs at a time and keep them for as long as you like. Users compile an online list of films they want to see. When they return a DVD in its pre-paid mailing envelope, the next one on their list is delivered, usually overnight. Netflix has more than 18,000 movie titles on offer, which would overwhelm most bricks-and-mortar stores. But it also tries to build a sense of community amongst its members, encouraging them to write reviews and to compare and discuss their viewing lists. Just as Amazon does with books, Netflix also makes personal recommendations based on subscribers' past viewing habits.

Blockbuster is now trying to copy Netflix with its own version of online DVD renting. So too is Wal-Mart. But provided Netflix can keep up its service levels, it should stay ahead of the pack. It is expanding in other American cities and is planning to launch a service in Britain. Wal-Mart may be the world's largest retailer, but it is not an obvious brand for movie buffs to turn to.

The next big thing is likely to be video-on-demand. That is not necessarily a threat for Netflix: its business proposition is delivering movies, and whether a film arrives through the post or is downloaded

via a broadband link should not make any difference. The company plans to introduce its first downloading service later this year. But Mr Hastings expects only modest interest at first because DVDs are so easy and convenient to use, and many of the latest DVD players are portable. That could change, he reckons, once DVD players come equipped with wireless, high-speed internet links for downloads.

Tipping over

The main reason why people in the e-commerce industry are watching Netflix with such interest is that the movie-delivery business may be close to the “tipping point”, where offline rivals find that so many of their customers have migrated to the internet that their businesses are no longer viable. This can take time to happen, perhaps until leases on shops come up for renewal and declining revenues persuade proprietors to throw in the towel. In part of the San Francisco Bay area, Netflix has already achieved a household penetration of 7%, which could rise to 10% within a year.

In the travel industry, where 20% of bookings in America are now online, many high-street travel agents are already shutting up shop. As the offline world retreats, the online businesses will get another boost. That already seems to be happening in the music world, where traditional record shops are closing as millions of music files are downloaded, many of them to be stored on portable players.

The most successful portable music player, so far, is Apple's iPod. The introduction in America in February of a new, slimmer version proved so successful that the company delayed its European launch because of a shortage of hard drives for the machines (providing an opportunity for eBay entrepreneurs to offer these scarce items—at a premium—to customers in Europe). Thanks to the combination of its fashionable technology and its online music store, iTunes, Apple is now selling some 2.5m songs a week. But to expand its sales worldwide, it still needs to establish a music-downloading service outside America—and comply with many different copyright laws.

The music files available from iTunes are compatible only with Apple's iPod, but Apple has done a deal with Hewlett-Packard for its iTunes jukebox software to be pre-installed on that company's computers, which should increase its number of users. This summer, HP will also start to offer its own-brand version of the iPod.

Meanwhile, if rival manufacturers using a different system can get a foothold, Apple's early lead could be eroded. A number of big groups are challenging Apple. Wal-Mart, for one, is pricing its downloadable songs at 88 cents, as against 99 cents at iTunes. As with movies, Wal-Mart may not be a strong brand in music, but the retail giant cannot be dismissed lightly. Microsoft and Sony are among the other companies working on new players and online music services. And further disruption could come in the form of different products. Mobile phones, for instance, are carried around by people most of the time, so it seems likely that they too will become portable music players.

Online music is potentially big business, but people have to be persuaded to pay for it. When Napster operated an illegal file-sharing service for music fans, up to 50m people a day were using it. The music industry hounded such services through the courts, and in America even brought legal action against some users. Napster, which is now owned by Roxio, a Silicon Valley software firm, has been reinvented as a paid-for service, and is promoting subscriptions rather than payment for individual tunes.

The movie business is watching closely how music is sold online, but has yet to devise a coherent strategy for managing the transition to the web. This would seem to be an ideal job for IAC's Barry Diller, who reckons Hollywood is “completely challenged” by technological change. Following a long career as a Hollywood mogul, he became intrigued by the commercial possibilities of the internet in the late 1990s. In 2001 he sold the cable, television and film parts of his company (then called USA Networks) to France's Vivendi Universal for $10.3 billion. So far, he has spent more than $10 billion on a number of internet-related acquisitions.

Is he tempted to add a film or television company to his group? Not necessarily, he says; but neither does he rule it out if a “real opportunity” presents itself. There are few certainties in life, reckons Mr Diller, but he does see the internet as an economic certainty. All the basic plumbing will soon be in place, from the widespread adoption of broadband to the infrastructure needed for delivery companies to get goods to customers.

And yet the internet still remains capable of producing surprises. New services can leave people wondering how they ever managed without them. The most notable of these is the search engine.

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Spiders in the web

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Searching for profit has become highly competitive

THE tech folk in Silicon Valley knew something was up last year when another web spider appeared. Web spiders are powerful software programs that crawl around the world wide web, automatically analysing words, following links and collecting vast amounts of data. The catalogues they assemble are used by search engines to display an index of web pages in response to key words entered by a user. What was intriguing about this particular spider is that it belonged to Microsoft. Even the world's biggest software company cannot afford to ignore the power of search.

Only a few years ago, search did not seem to matter very much. The gateways to the internet were going to be “portals”: sites such as Yahoo!, Microsoft's MSN and AOL. These sites would provide users with everything they needed, including links to whatever internet pages the portals' editors deemed useful. The idea was to keep users cosseted within the portals, where they could be sold things, presented with ads and encouraged to sign up for additional services.

But Sergey Brin and Larry Page had a different idea. They started building a search engine that would not only examine the words on web pages, but also look at how and where those words were being used and at the number of other websites linked to that page. Their search engine would rank pages in their likely order of usefulness.

In 1998, the pair put their studies at California's Stanford University on hold to start Google. Having raised $1m, they set up in a friend's garage, answering 10,000 search queries a day. These days Google deals with more than ten times that number every second. Its search methods, which form part of a secret algorithm, have become far more elaborate. Put in the word Google, and you get links to over 45m other web pages in a quarter-second—with google.com at the top of the list. Instead of encouraging you to linger, Google's spartan website is designed to find links as quickly as possible and move you on. For many people, it is now their launch point on to the internet.

Despite its simple appearance, Google has found a way to make lots of money. Just how much became clear for the first time last month when the privately held company announced plans for a stockmarket listing, with its shares to be sold by public auction. Its net revenue in 2003 turned out to have been $962m, 176% up on the previous year. Google is an extremely successful company, but it is going to have a fight on its hands.

The way to make money out of search is to sell the words people put in when they look for things on the

web. This means that whoever bids the most for a particular term, “digital cameras”, say, gets their link on the top of a list whenever anyone types that phrase into the search box. The convention is to distinguish between independent search results and those that are paid for. Google lists its “sponsored” links on the right of its page; Yahoo! puts them in a box at the top.

Searches are now such an important tool for connecting buyers and sellers that some companies spend most of their marketing budget on getting a high page-ranking in the sponsored lists and on various services which can help websites move up the independent listings. A website operator could, for instance, pay a search-engine-optimisation company to help him design his site to maximise its page ratings. Such companies sometimes employ tricks such as setting up “ghost” web pages, which make a site appear more widely used than it really is. Google and other search companies constantly fiddle with their algorithms to try to prevent their independent search results from being manipulated in this way.

But there is also a grey area. Yahoo!, for instance, offers a service that lets traders pay to have their website re-crawled every 48 hours instead of waiting (sometimes up to a month) for a web spider's regular update of the search engine's catalogue of pages. Paying to be re-crawled ensures that when a search is carried out the company's latest products and prices will be included. Yahoo! says such payments do not buy a better placement in its independent results. But sites with more up-to-date information are more likely to be relevant to a search, and therefore tend to rise higher.

According to most analysts, the paid-search business is leading the recovery in advertising expenditure on the internet. A study by the New York-based Interactive Advertising Bureau in partnership with PricewaterhouseCoopers, a consultancy, found that online ad spending in America last year grew by 21% to $7.3 billion.

Count the clicks

The great advantage of paid search as a marketing expenditure is that it has a built-in evaluation mechanism: companies pay only if a user clicks through to them from a search-engine link. Companies can also track how many of those visitors eventually end up buying something, so they can work out just how much it is worth bidding for a search term.

Google's paid-search service, known as AdWords, in effect sells advertisers a “pre-qualified lead”, says Sheryl Sandberg, who runs the company's global online sales and operations. Google employs an automated bidding process using a version of what economists call a Vickery second-price auction. Winning bidders pay only one cent more than the bidder below them. Hence, if there are bids of $1, 50 cents, 25 cents and so on, the winner of the top place pays 51 cents a click-through, the winner of the second place pays 26 cents, and so on. This, Google believes, encourages companies to bid whatever they think a search term is worth, safe in the knowledge that the final price they pay will be less. But even payment does not necessarily guarantee the top slot. Google also ranks its sponsored links according to their usefulness, which means that if more people click on a sponsored link further down the list, that link can overtake sponsors who are paying more. “That way we reward relevance,” adds Ms Sandberg.

The opening shot in the search war came in February when Yahoo!, also based in Silicon Valley, sacked its neighbour Google as the provider of its search engine and replaced it with a proprietary service. Yahoo! has been investing heavily in search technology. In July 2003 it paid $1.6 billion for Overture Services, a company that pioneered much of the paid-search advertising business, and in March this year it agreed to buy France's Kelkoo for *euro*475m ($576m). Kelkoo operates an internet search service for comparison shopping. Google also recently put a link to Froogle, its comparison-shopping service, on its main site.

Yahoo!, which was also founded by two Stanford students, David Filo and Jerry Yang, has been growing strongly with the help of paid-search advertising. The first quarter of 2004 was the most successful yet in the company's history, says Terry Semel, Yahoo!'s chief executive. Both revenue and profits more than doubled on a year earlier, to $758m and $101m respectively. Yahoo! is transforming itself into a site that is part portal, part shopping mall and part search machine. Its strategy is based on what Daniel Rosensweig, Yahoo!'s chief operating officer, calls the “desert island question”: if you were stuck on a desert island and could have access to only one website, which one would it be? Abandoning Google, he says, gave Yahoo! a more differentiated product.

Yahoo! is also starting to integrate the results of its searches with other services it provides on its

website. For instance, it recently launched a service called SmartView that links searches with its online maps. This allows someone looking for a petrol station in San Francisco, for instance, to type in his location to get an interactive map with all the nearby petrol stations, and driving directions if required. Finding local information is becoming an area of hot competition.

Some people believe Microsoft could put a stranglehold on Google, as it did on Netscape in the battle to control the web-browser business. At the World Economic Forum earlier this year, Microsoft's founder, Bill Gates, admitted that so far Google had well and truly beaten his company in the search business. But Microsoft will try to leapfrog the existing search engines with its own technology and integrate its service within its own software, including its Office programs and the new version of Windows, known as Longhorn, due to appear in 2006. At present, searches carried out on Microsoft's MSN site are partly powered by Yahoo!'s search engine, but that relationship is likely to end once Microsoft introduces its own technology.

Windows runs more than 90% of the world's PCs, so this is bound to raise further antitrust concerns. As more computers become permanently plugged into high-speed internet connections, many more people will search directly without opening a web browser while working on a report or presentation. As with media players, the providers of rival search engines will be watching closely to see just how difficult Microsoft's new products will make life for them.

At present, search marketing is considered a relatively cheap and cost-effective method of finding customers, but there are only a finite number of search terms, says Kenneth Cassar, director of strategic analysis for Nielsen//Net Ratings. This means the price of popular search terms is bound to rise, which will encourage websites to find new places for context-based ads. Websites will also try to keep their exit barriers to users high, not least by making it more convenient to stay with them than to start again somewhere else, with all the hassle of filling in personal details and credit-card information.

The search business is still young, and could fragment into many different products for different purposes. That would provide opportunities for newcomers beside Microsoft. Ask Jeeves, for one, has become a slightly less distant third after improving its technology. And there are a number of smaller companies that could yet produce a breakthrough product with mass appeal, just as Google did when it operated out of a garage.

More specialised searches, such as those concentrating on web pages that match users' interests, will be a big area of development. Someone entering the word “tuning” on a car-related search, for instance, would no longer have to scroll past links about musical instruments, television stations and faster software to find pages that explain how to adjust car engines. Search sites could also “learn” about users' interests from the links that are clicked through, or users could be invited to provide their personal preferences. Google and Yahoo! have already gone some way down this route. Both, for instance, now operate news services that not only report the latest events but also allow users to search through thousands of publications to retrieve past articles.

Advertising helps pay for the internet's free services, such as search. To continue to get these things free, users may have to be prepared to accept ads. Gmail, a new free e-mail service which Google is testing, offers users more than 100 times the storage space of rival e-mail services, in return for agreeing to sponsored links being placed in their e-mails. Google's computers analyse the content of an e-mail and then dish up ads that seem appropriate.

Worth paying for?

Those who want to avoid ads, find a wider range of useful information or make sophisticated searches on the internet are increasingly being asked to pay. Online newspapers and magazines are one example: the free searches provided by search engines often link to pages available only on subscription.

Even though so much information is available free, it can be worth paying to use a specialist search service, says Clare Hart, the boss of Factiva, a web-based news and business-information service. A joint-venture between Dow Jones and Reuters, it has around 1.6m paying subscribers and draws on almost 9,000 sources in 22 different languages, many of which are subscription-only. The tools of the system are designed to allow more precise searches and to provide results in a single format.

Some companies use such services to provide virtual “clippings”—all the stories from newspapers and magazines that mention their firm or their product. But just think how much more valuable it would be to

know in advance what might be written about you in future. A new type of search engine could get close with an automated process called data mining. WebFountain has been developed by IBM's research centre at Almaden, California, to use text analysis as a way of identifying trends, patterns and relationships from massive amounts of both unstructured and semi-structured text, ranging from bulletin boards, chat rooms, web logs, newspapers and trade journals.

Factiva has licensed the technology to provide a new reputation-management service, launched this month. The idea, explains Ms Hart, is that, say, a brand manager will be able to see how his company is being perceived on the internet without having to keep checking hundreds of different sites, some of which he may not even know about. This could provide an early indication of trends and troubles.

Companies could also use such services to find out what their rivals are up to. Nor would they have to be big and powerful to do so. One of the most heartening aspects of e-commerce is that the little guys often have the edge.

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Unlimited opportunities?

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The internet offers huge scope for both business and leisure, but security urgently needs to be improved

THERE has never been a better time to start a business, especially an e-business. The internet has dramatically reduced the cost of setting up, and especially of reaching customers. For about $1,000, you can buy a personal computer. A high-speed internet connection with enough space for a good website will cost around $40 a month. Marketing costs, provided you have something interesting to sell, could amount to bidding a few cents for a search-engine keyword. For a commission, sites such as eBay and Amazon will also list your wares. PayPal will look after credit-card payments, saving you the bother of establishing a merchant account. And firms such as UPS will deliver anywhere, and provide online tracking facilities for checking how far a parcel has got.

All over the world, people have begun businesses this way. They might be selling avatars (virtual personas for online gaming) in South Korea; tribal carvings in South Africa; model steam-engine parts in Germany; or classic Corvettes in California. Web publishing too can now more easily be supported by advertising. Some online companies will find and place ads on your website for you, and split the revenue. Google's AdSense service, for instance, uses the search engine's technology automatically to match the content of a website with appropriate text-based ads. The more popular a site becomes, the higher the income.

E-commerce could yet turn into one of the biggest business start-up schemes ever. In a recent study, eBay found some 430,000 people in America alone who now make a full-time living or earn a substantial secondary income from trading on its site. Every year eBay holds a big get-together for its army of online entrepreneurs. Google, too, knows plenty of people who have profited from ads placed on their website.

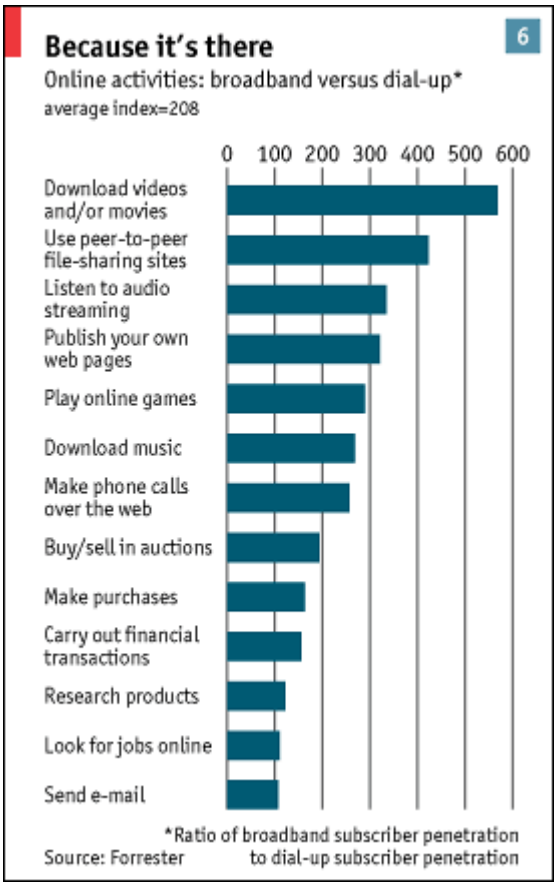
From hobby to business

During the height of the dotcom boom, websites put together by enthusiasts, hobbyists or collectors were seen as fringe activities with no profit potential. Yet such people often know their subject very well, and use the internet for what it is extremely good at: finding others with similar interests and passions. Many of them have discovered sufficient numbers of like-minded people to encourage them to set up small businesses—and sometimes not-so-small ones: eBay, started by Pierre Omidyar in the time-honoured fashion on a computer in his bedroom, began as a trading platform for collectibles.

High-speed internet connections boost online activity all round, as demonstrated by South Korea, where some two-thirds of households have broadband. A study by Forrester showed that in Europe subscribers with broadband use their computers to do more than twice as many things online as consumers with slower internet connections. They also tend to do different things, such as downloading more movies and music files. And they publish many more web pages (see chart 6).

The most commonly found ingredient in commercially successful websites, apart from original ideas, is careful analysis of how people use the site. That information can be used to develop additional services which make the site even more attractive to users. These dynamics are expressed in complex mathematical formulae which are increasingly seen as a strategic asset. The people in charge of the sums are beginning to be represented at board level. Amazon, for one, has appointed its first chief algorithms officer.

By growing organically, commercial websites tend to develop loyal followers. Orbitz's Jeffrey Katz likens these groups of users to “cults of internet behaviour”. They may be eBayers, Yahoo! addicts or devotees of craigslist, a non-profit site providing networking, goods for sale, jobs and other links in different cities. Many people now organise their online lives around their favourite sites, in much the same way as people used to visit their favourite shops in the high street. As retailers have consolidated, giant out-of-town stores have put many of the smaller shops out of business and now threaten some department stores. “In the era of Wal-Mart, main street doesn't exist any more,” says Google's Sheryl Sandberg. But you can still find something like it online. Moreover, as she points out, small traders can still get into business from a PC in their bedroom.



But will retail power on the web eventually become consolidated too? So far, Barry Diller's IAC is the closest thing to an internet conglomerate. Last year its net revenue was $6.3 billion. Already its various websites are able to sell such disparate things as a holiday to Miami, an introduction to a new girlfriend when you get there, an engagement ring, a wedding package, a new home and a mortgage to help the couple pay for it all.

So far, the group's various sites still operate largely as independent companies. They include IAC's online travel agents, such as expedia.com, hotwire.com and hotels.com; electronic retailing (including the televised and website services of Home Shopping Network); Ticketmaster; local, entertainment and personal services (including match.com); and financial services (such as lendingtree.com). Mr Diller says he does not believe in forcing synergies. He is leaving his e-commerce businesses alone so they can concentrate on becoming market leaders in their different segments. Some of these, he says, are still at an early stage of development. “We do think there's a stage two,” he adds. “Many of our properties very naturally relate to each other.” So will there be more cross-selling and combined branding? Perhaps, but only in good time, says Mr Diller.

Amazon, eBay and Yahoo!, in their own ways, are also building conglomerates where all sorts of goods and services can be found. In the process, they are starting to resemble each other. But it remains to be seen if anyone can build an online version of Wal-Mart that could ruthlessly drive down costs. Many hotels have already rebelled against large online reservation services by promoting their own sites. On the internet, it is easy for suppliers to start selling directly because they do not need a store to operate from.

Even walmart.com does not seem to be considered particularly threatening by most other e-businesses, perhaps because creating a virtual superstore is not in itself enough to make much of a difference. The real power of e-commerce is not just the ability to buy things online and have them delivered, but how it can change the way people live and work.

A new life

“In 2001 it was unimaginable to think that by 2004 I would not have to leave home any more and, short of needing surgery, could get everything I want from a combination of e-mail and websites,” says Marian Salzman, chief strategy officer for Euro RSCG Worldwide, a big advertising agency. Based in New York, she believes more people will use the internet to work from home, either running their own businesses or teleworking for companies. For example, instead of outsourcing more call centres to India or other developing countries, companies might employ people in America or Europe who have good practical knowledge of products or services and can deal with inquiries from home.

However, not everyone has a computer at home, and some people may never get one. “The internet is wildly empowering for people who want to participate, but they are part of a digital elite,” says Ms Salzman. So the 24% of households in America that have no internet connection are missing out on many things, not least information on products and prices. Perhaps another generation, familiar with computers from school, will have to grow up before that changes.

Meanwhile, conducting business online will continue to get easier. Microsoft, for one, is working hard on all manner of B2B applications, including some that will allow its Office suite of programs to be closely integrated with e-commerce activities. This will help small and medium-sized businesses, many of which work together in “business ecosystems”, says Charles Fitzgerald, a senior Microsoft manager. In the future, he adds, groups of companies will increasingly use systems that pull together the information held in different parts of their organisation.

Consumers should expect something similar to happen. In the near future, an online shopping service could make recommendations on the basis of personal information, such as checking the diaries people keep on their computers (provided they have given their permission). For instance, a customer might get an e-mail reminding him that it is his mother-in-law's birthday next week, along with a suggestion for a present, plus a note of what he sent last year. One click, and the present could be ordered and dispatched.

Microsoft is already building the necessary tools for such services into its next generation of software. Mr Fitzgerald stresses that the model would be “permission-based”: customers would first have to agree to give sites access to their personal information. If they think the services are useful, some of them may well do so. But others already feel that spam, computer viruses, fraud and the theft of personal data are making the internet a dangerous place, and that access to their computers needs to be restricted, not opened up.

A strong economic incentive may well persuade some people to part with more information about themselves, but any abuse would cause a huge backlash. Much irritation has already been caused by aggressive internet marketing, such as persistent pop-up ads, says Hal Varian, professor of information

management at the University of California at Berkeley (and an adviser to Google). Nor, he adds, do people much like “bait-and-switch” tactics, used by some traders to make their prices look attractive in shopping-comparison searches. Having lured a customer to their site, the trader will try to switch the buyer to a more expensive item.

Of course, *caveat emptor* applies as much online as its does offline. But abuses on the internet are not confined to sharp practice: criminals also use the web for much nastier things. Reliable numbers are hard to come by, not least because people would rather not admit to having been defrauded, nor do websites welcome publicity about crime. But there is plenty of evidence that all sorts of scams flourish on the internet, from identity theft to phoney auctions and bogus requests for data. Companies have to work hard to stay ahead of criminals.

EBay's Rajiv Dutta insists that the share of problem transactions on his company's site is very low. Users are more likely to have their credit-card information stolen in a local shopping mall than on his website, he reckons. Still, eBay employs some 800 people around the world to police its auctions. Other sites also watch out for suspicious activity, most recently from criminal internet traders based in east European countries.

Last year, losses of some $200m were reported to America's Federal Trade Commission. Nearly half the complaints involved online auctions. According to some analysts, 2003 was perhaps the worst year on the internet so far for criminal and obstructive activity, such as virus attacks. This has to be brought under control, or else consumers will retreat. Crime may yet prove the biggest threat to the development of e-commerce.

A measured response

It is the internet's very openness that makes contact between buyers and sellers so easy and potentially so rewarding. And just as it would not have made sense to shut up the high street because it harboured some thieves and rogues, it would make no sense to combat cybercrime by stopping all internet commerce—even assuming it could be done. But better locks and security systems are urgently needed. And at least some of the problems are due to glaring errors and omissions by software companies and firms that build websites and manage internet connections.

For most people, most of the time, the internet is a great place in which to go exploring, to buy, to sell and to make a living. But a more secure environment would make it better still.

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Pharmaceuticals

Glaxo's big challenge

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Bloomberg News

Can GlaxoSmithKline's well-paid but much-criticised boss, Jean-Pierre Garnier, prove the sceptics wrong?

ONE year ago, furious shareholders voted against the pay package of Jean-Pierre Garnier, the boss of GlaxoSmithKline (GSK), on the grounds that it would reward him handsomely even if he were to prove a failure. No such fireworks are expected at next week's annual meeting of the drug giant, at which his revamped remuneration is likely to be approved. Shareholders are more likely to debate whether Mr Garnier is actually failing.

GSK is behind schedule in delivering the fruits of the largest merger in the history of the drug industry, the $30 billion marriage in 2000 of Glaxo Wellcome and SmithKline Beecham. When most analysts and investors look at GSK, they see a pipeline of new drugs of unproven potential, and financials with an obvious downside for the foreseeable future. GSK is second only to Pfizer by revenues and market capitalisation. But its shares trade at 15 times estimated 2004 profits, compared with the industry average of 25.

Like other big drug firms, GSK is desperately fighting generic competitors. It is quite likely that, before long, generic drugs will reduce GSK's annual revenues by $3 billion-4 billion by grabbing sales from its best-selling Wellbutrin and Paxil anti-depressants and Augmentin antibiotic. GSK's prospects for this year would be even worse if it had not won regulatory approval for more patient-friendly versions of those drugs, and seen robust growth in respiratory products such as Advair.

Things are unlikely to improve soon. The weak dollar is depressing profits. About half of GSK's sales are generated in America, but the firm's results are reported in sterling. GSK's revenues are forecast to be flat this year, and earnings per share to fall by 6%. Moreover, the presidential election campaign in America, with its drug-industry bashing, will probably weigh on drug shares until the vote in early November, and perhaps longer. In fact, Mr Garnier expects political pressure on pricing to continue for the foreseeable future.

A spoonful of sugar

Yet if all these factors depress Mr Garnier, he shows no sign of it. Forswearing the favourite strategy of big drug firms—yet another merger—he proclaims that, although the GSK glass may look half-empty today, it will soon fill up as the work of the past few years begins to pay off. Above all, he expects GSK to reap the rewards of a fundamental restructuring, conceived by Mr Garnier and executed by his former SmithKline Beecham colleague, Tachi Yamada.

Most of the 40 or so drug-industry mergers in the past decade were justified by savings from eliminating staff and other costs in overlapping back-office and sales operations. GSK has attempted something far more radical.

Many of the jobs held by the new firm's combined workforce of over 100,000 have been reshuffled. Crucially, 16,000 researchers were redirected; the most senior, in particular, were made to abandon their risk-averse, ponderous ways. Instead, they were put in new autonomous “centres of excellence” built around a specific therapeutic focus, such as treating cancer or AIDS. Further change lies ahead. Mr Garnier expects to do far more drug trials in developing countries such as Poland and India. And GSK has formed a research partnership with Ranbaxy, an Indian drug firm traditionally focused on generics.

Rather than follow the industry's cautious trend of reducing exposure to the sort of risky biotech deals that were typical of drug firms' licensing and outsourcing in the mid-1990s, GSK's commercial-licensing team has been encouraged to be open-minded and opportunistic. In 2002, in the middle of a drug-market downturn, GSK signed new collaboration deals (worth over $1 billion) with biotech companies such as Nobex, Exelixis, and Adolor.

In the racy 1990s, Mr Garnier's gambit would have been praised as the stroke of genius it may yet prove to be. Its sheer scale would have been rewarded by investors. But in today's more sober climate, investors are, so far, unmoved by GSK's savings of nearly $6 billion in the past four years, and the creation of one of the industry's largest pipelines. This now contains 80 new product prospects, half of which have reached advanced stages in clinical trials. In 2001, when Mr. Garnier gave Mr Yamada hands-on responsibility for key aspects of the restructuring, GSK put ten drugs into phase-one trials. Last year, 20 made it there, and the number of compounds that advanced to phase-two and phase-three trials nearly doubled, to 44.

Given the recent innovation drought in the drug industry, which afflicted GSK as much as any firm, shareholders are viewing this pipeline with extreme scepticism. Yet, if historic odds in drug development hold, in the next 12 years around 16 of those 80 prospects will make it to market. Among the likeliest is a breast-cancer medicine known as 572016, or just “016”, whose “mechanism of action” and molecular targets are roughly akin to Genentech's Herceptin—a commercial hit for that firm. It could also help treat a variety of cancers, starting with solid tumours in the bladder, gut, head and neck. Now in the final phase of trials, 016 has won fast-track status from the Food and Drug Administration (FDA). As well as potentially working on several cancers, it may let doctors treat cancer patients in a less-intensive, more routine way—similar to treating a chronic disease such as arthritis or diabetes.

GSK may have data on 016 by this autumn, with submission to the FDA planned for next year. If approved, analysts predict peak annual sales of $900m. If it is also approved for other cancers, 016 could become for GSK what Lipitor is to Pfizer: a $10 billion product.

GSK may have a rival to Lipitor—or, at least, a drug that could be used as part of a combination therapy to treat coronary-artery disease. Known as 480848, this drug has shown promise in reducing inflammation that is associated with arteriosclerosis. Some patients develop this inflammation even when they have low levels of cholesterol. Some cardiologists believe that the lipoprotein target at which the new drug is aimed is a contributing factor in a many heart attacks and strokes.

Anti-cholesterol drugs such as Lipitor are the industry's big sellers these days, generating $20 billion in revenues last year. If GSK has indeed found the drug to tackle another suspected cause of heart attacks, the rewards could be huge. It will soon submit this drug, developed by long-time biotech partner, Human Genome Sciences, to the FDA for clearance to start a phase three trial. If the FDA gives the go-ahead for the trial on a fast track, GSK could submit it for approval in 2008.

For all today's gloom about pricing pressure and the growing competition from generics as patents expire, the fact is that, for GSK to prosper, Mr Garnier's pipeline does not even have to gush. If it can only start to produce a steady flow of winning drugs, that would go a long way to proving that consolidation can be good for shareholders and the sick alike, and that bigger need not always mean duller. Indeed, that prospect raises an intriguing thought. If its shares stay at current levels, might GSK

itself become the target of further consolidation? It would not be the first firm viewed as “too big to buy” to find itself the target of a bid.

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Biotechnology

On the mend

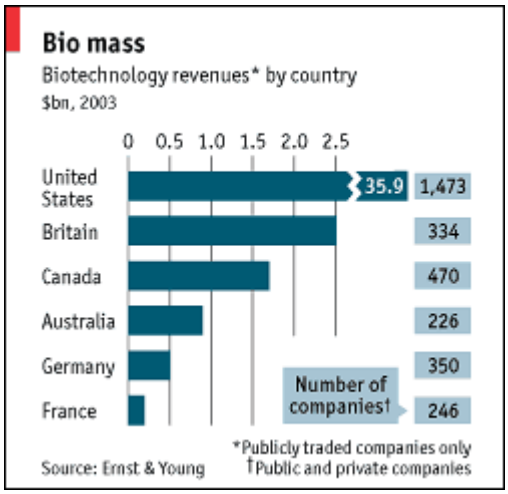
May 13th 2004
From The Economist print edition

Brighter prospects for biotech in America and Asia

Get article background

AFTER four years of investor fever, then chills, the biotech industry appears at last to have settled into stable good health—in America, at least.

According to new reports on the biotech industry by Ernst & Young (E&Y), an accounting and consulting firm, America's 1,473 biotech firms attracted $14.4 billion of new investment last year, two-thirds more than in 2002. Venture capitalists were particularly keen, although even the public markets warmed to biotech. The industry's market capitalisation rose by more than 50% to almost $300 billion in 2003. Seven American biotech firms carried out initial public offerings of their shares. Scott Morrison, head of US Life Sciences for E&Y, reckons that as many as 30 American biotechs could go public this year.



America's biotech industry may be attracting more money because it is making more. The revenues of public biotechs were almost $36 billion last year; at this rate, predicts E&Y, America's public biotech industry will actually be profitable by 2008. These firms have now produced several billion-dollar blockbuster drugs, and show every sign of delivering more: last year, 25 new biotech drugs were approved by America's Food and Drug Administration. Another 300 biotech drugs are in late-stage trials.

Such productivity is reflected in lucrative deals with big drugmakers which are struggling to fill their own sluggish R&D pipelines. And, notes Mr Morrison, the past few lean years have forced biotech firms to usefully refocus their resources and restructure their businesses.

Meanwhile Asia's fledgling biotech sector is also growing rapidly. There are now an estimated 667 biotech firms in the Asia-Pacific region, with clusters developing in Australia, India, China, Singapore and Japan. Though immature compared with America, Asia's biotech industry is already starting to rival it in certain niches, such as drug screening and biotech-drug manufacturing.

The outlook is less happy for Europe's biotech industry. Last year, revenues fell, R&D spending was cut and employees were laid off. Although European biotechs raised some money in the public markets, their venture financing fell by 10% compared with 2002. As E&Y points out, Europe's biotech firms may fall even further behind their American rivals (which could simply buy them up), unless they can get more drugs to market faster. There is an urgent need for wholesale restructuring, and for consolidation to build critical mass. Or else biotech may join the long list of examples of Europe's lack of competitive edge in high-growth sectors.

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Hollinger International

Black days indeed

May 13th 2004 | NEW YORK
From The Economist print edition

Conrad Black's troubles deepen

THINGS have taken yet another turn for the worse for Conrad Black, the newspaper owner accused of wrongly taking money from his company. This week, a modified lawsuit from Hollinger International, the firm he "controls" with special voting shares, accuses him, his wife, his firms and three colleagues of racketeering under the Racketeer Influenced and Corrupt Organizations Act (RICO). Hollinger International is now seeking some $1.25 billion from its former management.

The RICO law was originally designed for use against organised crime and drug traffickers. It helped defeat some New York Mafia families in the 1980s. Then prosecutors used it against Michael Milken, a junk bond trader, in 1989. Since then, RICO, a criminal statute, has often been used in civil actions because it can result in triple damages. Lord Black's spokesman this week called the racketeering charges "tabloid journalism masquerading as law".

One shareholder in Hollinger International maintains that the lawsuit is "serious and credible". The man primarily responsible for it, Richard Breeden, a former chairman of the Securities and Exchange Commission, is not the sort to bring a frivolous action. His inquiry into money taken from Hollinger International still continues. He may yet seek even larger sums from Lord Black and associates. With each fresh accusation, speculation grows about a possible criminal prosecution, which might seek to put Lord Black in jail.

As well as old allegations that Lord Black wrongly took money via inflated management fees and "non-compete" payments when newspapers were sold, the suit details other ways in which they allegedly used Hollinger as "a cash cow to be milked of every drop of cash". From 1998, for instance, Lord Black and his former right-hand man and now co-defendant, David Radler, allegedly used a firm called Horizon to buy some of Hollinger International's newspapers at below-market prices. In one instance, Horizon allegedly persuaded Hollinger to sell it two papers, the *Skagit Valley Argus* and the *Journal of the San Juan Islands*, for $1 and to pay Horizon $150,000 to cover the papers' debts. Hollinger International's board was not told that a third party had offered roughly $750,000 for the *Journal of the San Juan Islands* alone.

The suit also alleges lesser abuses, including by Lord Black's wife, Barbara Amiel-Black. It quotes her, from a *Vogue* article, describing herself as having "an extravagance that knows no bounds". She allegedly charged Hollinger International for a tip to the doorman of Bergdorf Goodman, a New York department store. The Blacks rode around in a 1958 Silver Wraith Rolls Royce. Hollinger International was billed $90,000 for refurbishing it.

Meanwhile, Hollinger International, which owns Britain's *Daily Telegraph* and the *Chicago Sun-Times*, still hopes to sell itself. Its investment bank, Lazard, recently put back a deadline for bids until later this month—perhaps due to all the lawsuits. Potential buyers, which include private equity firms and Britain's Daily Mail & General Trust, fear that they could, in turn, end up the target of lawsuits if they enter this legal maelstrom by purchasing the firm. And yet they might gain if the company recovers money from Lord Black after they buy it—and the firm's share price has been rising steadily. Hollinger International is considering issuing litigation warrants so that any firm that buys its newspapers can share in money collected from Lord Black and his colleagues.

Mr Breeden's latest salvo will cheer Hollinger International's board of directors, including Henry Kissinger and Richard Perle, an ex-chairman of the Pentagon's Defence Policy Board. It mostly heaps blame on Lord Black and associates, not them. In January, a lawsuit filed by Cardinal Value Equity Partners against the directors alleged that they stood by while Lord Black and others took money. Mr Breeden's suit

describes at length how information was withheld from the board.

Mr Radler has issued a statement declaring that this week's lawsuit “acknowledges that many of the things Mr Radler is being accused of were presented to the board, considered by the board, and approved by the board, yet it somehow fails to implicate the board in any of the alleged misconduct.” Whether that will suffice as a defence in today's climate, who can say?

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Airlines in central Europe

Spreading wings

May 13th 2004 | WARSAW
From The Economist print edition

Yet more low-cost start-ups

HAVING flourished in America and western Europe, budget airlines are now catching on in the eight ex-communist countries that joined the European Union this month. Joining the EU has also made them members of its “open skies” internal market. Despite investor worries over lacklustre results at western Europe's budget leaders, Ryanair and easyJet, and anxieties about soaring jet-fuel costs, there is no shortage of new hopefuls in the East.

Wizz Air, a Budapest-based carrier, will begin flights on May 19th from Katowice, in southern Poland, to London, Milan and Rome. SkyEurope, central Europe's leading low-cost airline, whose main base is in Bratislava, will start services on June 14th from Warsaw to several western European cities, including Paris and Amsterdam. Air Polonia, a Polish charter airline that doubles as a no-frills operator, started flying last December from provincial cities to London, and has since added Brussels and Athens. Even airBaltic, Latvia's tiny flag-carrier, offers low-fare services.

The new budget carriers see central Europe, where GDP per head is roughly 40-60% of the EU average, as fertile ground for their services. They may also have noted that the market leaders in western Europe have largely ignored the area, though easyJet offers flights to Prague, Budapest and Ljubljana.

The region's flag-carriers have failed to create a mass market for air travel, perhaps because most central Europeans cannot afford their fares and are accustomed to taking trains and cars. Cheap tickets, the low-cost airlines believe, will fuel demand, partly from price-conscious business travellers but chiefly from people who have never flown before, just as has happened elsewhere. Poor road and rail networks leave the field wide open to budget airlines.

Yet the low-fare model faces even more daunting challenges in central Europe than elsewhere. Low credit-card and internet penetration-rates could hinder development of the online booking systems that allow the likes of Ryanair and easyJet to attract travellers and keep costs down. And central Europe's airport infrastructure is limited, with few of the small, cheap secondary airports so useful to budget carriers. This is one reason why Ryanair, which favours deals with hungry secondary airports, is wary of flying to central Europe.

Although Wizz Air claims that its base in densely populated Katowice will pay off, it may struggle to stimulate demand among still hard-up Poles, or to lure British and Italian passengers to drab Silesia. SkyEurope, with its first-mover advantage, is the likeliest to succeed. With low costs and ample slots at its base in Slovakia, which forfeited its national airline after splitting from the Czech Republic in 1993, it markets Bratislava as a secondary airport for nearby Vienna, allowing it to tap into demand for low-fare services from wealthier Austrians. As Christian Mandl, SkyEurope's Belgian chief executive, puts it, “We have the best of both worlds.”

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Sony

Off to the movies

May 13th 2004 | NEW YORK AND TOKYO
From The Economist print edition

Sony wants to buy another film studio, but that will not solve its problems

Get article background

IF SONY buys MGM it would create a movie business big enough to rival America's entertainment giant, Time Warner. That would be something of a triumph; in 1994 Sony was the laughing stock of Hollywood after writing off $2.7 billion of reckless spending at its movie division. With its film business now earning solid profits, it has made a preliminary bid of $5 billion for MGM, jointly with two private equity firms, Texas Pacific Group and Providence Equity Partners, who would put up a lot of the money. The bid could yet turn into a fight: both Time Warner and NBC, General Electric's media division, are also said to be interested in MGM.

MGM offers a vast library of more than 4,000 films, which include "Dr Zhivago", the James Bond and Pink Panther series, 19 Woody Allen movies and over 200 Academy Award winners. The studio already earns hundreds of millions of dollars by recycling these titles via pay television and DVDs. If Sony and its partners do get MGM, they will be betting that demand for old movies will grow further as cable and satellite firms get better at delivering on-demand video services to the home. On top of likely cost savings from combining MGM's film distribution with that of Sony Pictures Entertainment, having the biggest film library could become even more of a goldmine if customers can be persuaded to replace existing DVDs with new high-definition ones. Yet MGM's billionaire owner, Kirk Kerkorian, has sold and later bought back the studio twice before, and his price demands—and habit of selling at the top of the market—may yet scare off Sony and partners.

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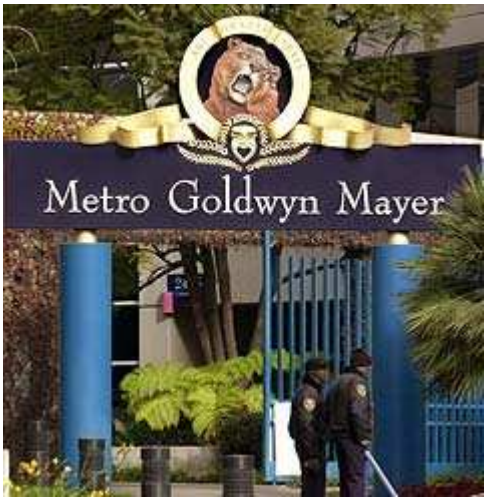

Will MGM help Sony roar again?

In music too, Sony is trying to bulk up. The merger of Sony Music with Bertelsmann Music Group—aimed chiefly at cutting costs—is expected to get regulatory approval in Europe this summer, albeit with strings attached. But in contrast to movies, Sony is on the back foot in music, even though Andrew Lack, the music division's new boss, has brought some cost discipline to the business.

Sony recently launched Sony Connect, a digital music-download service, to compete with Apple's iTunes. Users will be able to listen to downloads on a variety of Sony devices, some far cheaper than Apple's iPod. But it may be too late to catch Apple, which has two-thirds of the market in digital music players and downloads.

Moreover, none of these developments will solve Sony's fundamental problem, which gets worse by the day. The firm urgently needs a clear strategy for the broader group, which makes a vast array of increasingly unprofitable gadgets. Last month, while Japanese rivals such as Sharp, Sanyo, Pioneer and Matsushita (owner of the Panasonic brand) were trumpeting strong annual results, Sony had to explain to investors why operating profits fell by almost half, to ¥99 billion ($876m), on almost-flat sales.

Despite booming global demand for DVD recorders, flat-panel televisions and digital cameras, Sony's electronics division posted a ¥35 billion operating loss. Prices of games consoles and other electronics devices continue to slide. This year, the firm will take yet another round of hefty restructuring charges, of maybe ¥130 billion. Its goal of achieving 10% operating margins by March 2007 seems increasingly improbable.

The weakness in games, where operating profits fell by 40%, is especially worrying, as this division has lately generated most of Sony's profits. Sales of its PlayStation 2 are falling. To slow the decline in unit sales, on May 11th Sony announced that it would cut the price of its consoles in America. Moreover, the PSX, launched last year, which combines a game console and video recorder, has disappointed. Sony expects a fillip from the PSP, a portable game console that it will release in Japan later this year. But the successor to PlayStation 2, due in 2006, will have a far bigger effect on its fortunes—and will face stiff competition from Microsoft's Xbox.

One of Sony's problems is common to all Japanese electronics firms. Shin Horie, an analyst at Goldman Sachs, says that these firms are struggling to adjust to the industry's new, more horizontal approach to making devices such as mobile phones and digital cameras. Firms outside Japan are increasingly focusing on specific areas of the production chain, from chips to sophisticated components, assembly to marketing. This allows, say, American, European and even Korean firms to marry their particular strengths with the advantages of cheap manufacturing in China and Taiwan. The Japanese are fighting this trend, says Mr Horie, by upgrading their existing vertical (do everything in-house) model.

A vertical strategy may work for some Japanese rivals, but for Sony it is an especially daunting leap. It lacks an advanced chip business such as those of Matsushita, Toshiba and Fujitsu. Sony spent 46% of its total capital budget on semiconductor investments last year, as part of a three-year, ¥500 billion effort to catch them.

Sony's adventures in medialand extend its reach further than any of its Japanese competitors. Not only does it want to design and make its own devices, it also hopes to control much of the content that will be streaming through them.

Does that still make sense? At one time, Sony hoped that by owning content it would drive its consumer-electronics sales, and vice versa. Increasingly, says one investment banker in New York close to Sony's management, its top people now regard entertainment and the electronics and gaming businesses as separate concerns. The entertainment business is earning more respect from head office than ever, says its boss in America, Howard Stringer. Buying MGM would further enhance the stature of content in the firm. But Sony's real challenge is to sort out its consumer electronics and gaming core.

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Microsoft

Kinder, gentler?

May 13th 2004 | REDMOND
From The Economist print edition

Microsoft says that it has grown up and learned how to share

TO HEAR the voice of the new, reformed Microsoft, the one that no longer acts like a bullying monopolist but like a responsible industry leader devoted to the public good, talk to Brad Smith, its general counsel. The bad old days, when Microsoft and the rest of the industry were “clobbering each other”, are over, he says. Microsoft has decided to grow up, make peace with its enemies and work with its industry to form open standards and share vital technology.

How enlightened. Mr Smith's claims may even be true. In April, Microsoft called a truce with Sun Microsystems, its arch enemy for more than a decade, and announced that the two would settle their pending litigation and make their software work together. Two weeks later, Microsoft made peace again, this time with InterTrust Technologies, another company that had been at war with Microsoft over contested technology patents.

Microsoft is not only settling law suits, but turning companies that it has not even offended into new allies. On May 3rd, it announced a huge cross-licensing agreement with Siemens, a German electronics giant, that will give the two companies access to many of each other's patents. This week it announced another cross-licensing deal, this time with SAP, the leading provider of high-end business software. Before last December, when Microsoft decided on this radical new approach, it had fewer than 20 such cross-licences in place, and it had granted no unilateral licences to other companies whatsoever. Now, says Mr Smith, it is in talks with more than 120 companies about sharing patents.

This is quite a change for a company that seems perennially to be fighting trustbusters in America and Europe, who accuse it of keeping its technology secret to retain an unfair advantage over rivals. Indeed, trying to appease the European Commission, which recently ruled against Microsoft, is certainly one of the motivations for this new openness. If Microsoft can demonstrate convincingly that it is willing to share the protocols that make other software applications work with Windows, Microsoft's ubiquitous computer operating system, it has a better chance of persuading the commission that it should still be allowed to bundle applications such as a media player into future versions of Windows.

Cynics add that the particular way in which Microsoft is choosing to reform itself—by emphasising its intellectual property even as it shares it—is only a cunning tactic in its battle against Linux, another long-term threat to its plans for world domination. Linux is an operating system and thus a rival to Windows. Crucially, it is also the main example of so-called “open-source” software, which is developed by a community of volunteers who share the programming instructions freely. Linux has been a surprisingly strong contender in the market for powerful server computers, the machines that power the datacentres of companies and governments. But Linux could also become a threat in the market for personal computers. On May 4th, Red Hat, the world's largest distributor of Linux, announced the launch of its first version of Linux specifically designed for desktop computers.

From Microsoft's point of view, the soft underbelly of Linux, and of open-source software in general, is legal ambiguity. Companies that use Linux and layer their own software on top of it can never be sure exactly who owns what, says Craig Mundie, Microsoft's chief technical officer. Customers opting for open-source software therefore run the risk that somebody somewhere might sue them. This is exactly what SCO, a small software firm in Utah that claims to own some rights to Linux, is doing. In March, it sued DaimlerChrysler, a big user of Linux, and it is threatening thousands of other companies with similar actions. Microsoft's cross-licences, therefore, are “an effort to portray Microsoft as the protector of intellectual property, while portraying the open-source patent picture as very murky,” says Matt Rosoff, an analyst at Directions on Microsoft, a consultancy that watches the firm closely.

Microsoft, sick of being second-guessed and always considered the bad guy, bristles at such presumptions. Cross-licensing is simply what mature industries do, says Mr Smith, and the technology industry is now maturing. Fortunately, Microsoft will soon have a chance to prove its maturity. Besides Linux, one of its biggest challengers today is Google, the currently dominant internet-search company. Microsoft would, of course, prefer that search, like all other vital functions, becomes a part of Windows, thus helping to maintain Microsoft's dominance in the long term. Exactly how Microsoft will now decide to attack Google is therefore a litmus test for whether it is serious about being open and playing fair.

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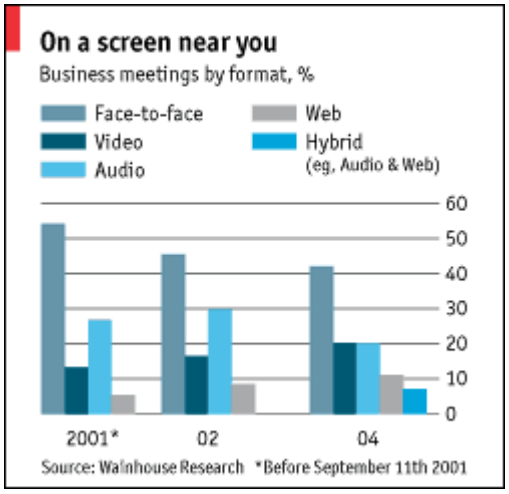
Virtual meetings

Being there

May 13th 2004
From The Economist print edition

Will remote-conferencing technology appeal in good times as well as bad?



NOBODY was surprised at the growth in audio, video and web-based conferencing after the terrorist attacks of 2001. Such technologies allow "virtual meetings" ranging from a simple three-way conference call to a fancy multimedia presentation beamed to hundreds over the internet. A sluggish economy, last year's SARS scare and lengthy security lines at airports have also fuelled interest. But as the economy rebounds, will enthusiasts of virtual meetings simply go back to real ones?

Apparently not, according to a new survey. Enthusiasm for virtual meetings has continued to grow (see chart). Having been prompted to try virtual meetings, many people seem to like them, says Ira Weinstein of Wainhouse Research, which carried out the survey.

But while virtual meetings are often seen as a cheaper alternative to travel, they are better understood as a middle ground between a phone call and a face-to-face meeting, argues Mr Weinstein. They save money, but they also save time. In a survey of business travellers carried out by MCI, a big American telecoms firm, 69% said they preferred a virtual meeting to travelling because it saved time, while only 37% said they did it to save money. Each has its place, argues Mr Weinstein. "Video conferencing is a perfect second-meeting tool after the first handshake," he says.

Growing fastest is "web conferencing", which usually combines a phone-based audio conference with a visual display (such as a slide presentation or software demonstration) delivered via a web browser. It grew by 40% last year, and hybrid web-audio conferences are now starting to displace audio-only conference calls. There is no need for fancy equipment, since most people already have a phone and a PC on their desks.

The boom in web conferencing was happening anyway, says Praful Shah of WebEx, the dominant web-conferencing provider, with 67% of the market. The firm's revenues grew from $2.6m in 1999 to $189m in 2003. "We were already on a fast track," he says, even before the technology started to get more exposure.

In a development that both heartens and scares industry veterans, Microsoft is now moving in too. This week it announced an alliance with MCI to deliver its "Live Meeting" web-conferencing service, based on technology obtained last year in an acquisition. The software giant's interest is an endorsement of the technology, but if it bundles conferencing into its Windows operating system smaller vendors could get wiped out. Whatever happens, the field is clearly hotting up, says Harold German of IVCi, a conferencing-systems and services firm. "Look at the virtual-meeting chessboard," he says, "and all these moves are happening now."

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Face value

The battle of big beer

May 13th 2004
From The Economist print edition

Will Graham Mackay triumph in the global bar-room brawl?

SIPPING tea in his wood-panelled office in Johannesburg, Graham Mackay, the boss of SABMiller, calls his firm a “turnaround specialist”. What he means is that the company, formed when South African Breweries bought America's Miller Brewing for $5.6 billion in 2002, is good at knocking assorted doddery brewers into profitable shape. But these abilities may soon face a severe test in China, where the South African could soon be leading the first hostile foreign takeover of a Chinese firm.

Bloomberg News

China is now the world's biggest beer market by volume. But it is gripped by price wars between the mostly local brands that dominate sales. In South Africa, Mr Mackay is used to having a huge market share, which he says is “about 98%” of the general beer market. This has deterred nearly all potential rivals from even trying to compete with SABMiller there.

Such dominance has allowed the company to devote much of its energy during the past decade to expanding abroad, buying up breweries in all sorts of countries. The empire has spread throughout Africa—which according to Mr Mackay “is extremely profitable, the returns are enviable to say the least”—to eastern Europe, India, America and China. SABMiller is now listed in London, where investors' pockets are deeper and the political risk less. With operations in more than 40 countries, it is now one of the world's three biggest brewers.

Alas, it seems that the days of cheaply gobbling up small breweries in southern Africa or the Czech Republic are over. Although there will always be a few mid-sized, family-run brewers determined to remain independent, thus preserving some variety in the beer industry, consolidation has been rapid. In March, Belgium's Interbrew struck a “combination” deal with Brazil's AmBev. They now form the world's largest brewer measured by sales volume. Mr Mackay, a computer-systems expert by training, is now engaged in two battles against the third giant in his industry, America's Anheuser-Busch, the owner of Budweiser—the “beer” that real-ale drinkers love to hate.

One of those battles is taking place in China, where both SABMiller and Anheuser-Busch are trying to gain control of Harbin Brewery, which is listed in Hong Kong. SABMiller bought a 29% stake in Harbin last summer, but recently launched a bid for the rest of the company after Anheuser-Busch tried to grab another 29% stake. The American brewer has yet to secure its stake and this week was still awaiting regulatory approval.

If Anheuser-Busch's purchase is confirmed, then whoever wins the ensuing takeover seems doomed to pay over the odds: at least $550m, or nearly 40 times last year's earnings. The prize is tempting, however, because the Chinese beer market is growing at 6-8% a year. It is also consolidating rapidly, not least because fierce competition among China's roughly 400 brewers has kept profits margins at a miserable average of 0.5%.

Mr Mackay, however, has played his hand badly. He concedes that his firm missed chances to buy Harbin earlier, for less and without having to fight Anheuser-Busch. Now he faces a nasty spat with the Chinese brewer's managers, who have been bad-mouthing SABMiller. Either they suspect that SABMiller's part-ownership of a bigger, rival brewer in north-east China could lead to the loss of Harbin's independence or they may have provoked a full bid for the company by SABMiller in a clever attempt to collect on lucrative share options. Either way, SABMiller has found itself looking arrogant or naïve, or both.

Mr Mackay emphasises that he does not want to be seen as “overbearing or imperial”. But is he, or his company, up to the challenges presented by China? Other purchases, such as that of a state-run brewery in Hungary, involved some similar difficulties. He talks of entering Hungary as a “baptism of fire”. The local brewer was poorly positioned in the market and in rotten financial shape. SABMiller was late getting there and others had been trying to buy it. But Mr Mackay's experience of tough, emerging and bureaucratic markets eventually triumphed.

Whether he can pull off the same trick in China remains to be seen. The task of winning the battle for Harbin may be complicated by his efforts on a second front: a much larger turf war across the Pacific, where SABMiller competes with Anheuser-Busch in its home territory. The purchase of the failing Miller brand from Philip Morris was far riskier than any other expansion by South African Breweries. Its executives talk about betting the house on the deal.

Brewers' droop

Most analysts were sceptical from the start, and sales of Miller's beers continued to droop. Critics doubted that an essentially South African firm could reinvigorate a tarnished brand in America. Nor did they believe that an outsider could cope with America's arcane post-Prohibition rules that separate brewers from distributors and retailers. Until six months ago the trends were unhealthy, admits Mr Mackay.

Now, however, SABMiller may be starting to prove the doubters wrong. Thanks to the sudden popularity of low-carbohydrate diets, such as Atkins and South Beach, sales of “low carb” beers like Miller Lite have soared. Moreover, beer distributors at a meeting in New Orleans earlier this year were cheered to be dealing with a genuine brewer, rather than with tobacconist Philip Morris. This is good news. Winning the support of independent distributors is crucial, for they, in effect, decide how much beer goes where.

When SABMiller's annual results are released next week, there should be some evidence of Miller's recovery. However, Anheuser-Busch is responding in kind to SABMiller's invasion of America. It recently started selling Budweiser in South Africa. Mr Mackay had better watch out. The clash in China seems to be an effort to spread the battle wider still.

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China's economy

Time to hit the brakes

May 13th 2004
From The Economist print edition

ImageChina

China's sizzling economy needs to be slowed down. The question is how quickly this will occur

BEIJING traffic jams get worse by the day as ever more people own cars. So impatient and unskilled are most drivers that a typical visitor will witness several collisions a day. Can China's policymakers be more successful in steering their racing economy on to a more sustainable path? Or, like the country's hapless drivers, will they be unable to avoid a crash?

Rumours are rife that the People's Bank of China is about to raise interest rates (one-year bank-lending rates are currently 5.3%) for the first time in nine years. The fact that this is even being discussed shows how concerned the Chinese leadership is about the investment boom. Wen Jiabao, the prime minister, said on April 28th that China will take “very forceful measures” to cool its economy. This was followed by reports of a temporary freeze on new lending by smaller banks, later played down by China's banking regulator. In early May the government announced tighter controls on investment projects and some new price controls. It clearly is desperate to curb new lending and investment.

The State Council, China's highest executive body, has issued new guidelines requiring companies to use more of their own capital and less debt to fund steel, aluminium, cement and property projects, the sectors which show most signs of overheating. Provincial government leaders have also been told to be stricter about approving investment in these sectors. On May 9th, the State Development and Reform Commission, the top economic policymaking body, instructed local officials to cap price increases in areas such as utility bills and public transport if inflation, currently 3%, rises much more.

Since last summer, banks' reserve requirements have been raised three times, but to little effect. Banks still have more than enough reserves. Tighter restrictions have been placed on property lending, and the central bank has also tried to use persuasion, asking banks to curb their lending to the overheating sectors—again with little apparent success.

In the year to the first quarter, bank credit surged by 21%, GDP grew by 9.7% and fixed investment by 43%. Inflation has risen from just 0.9% a year ago. Many economists reckon that the economy is even hotter than the official figures suggest. Based on electricity usage, annual growth may really be as high as 12-13%; and the true inflation rate is probably above 5%, as a significant number of prices are still controlled in some way by the government. On the other hand, official figures overstate the growth in

investment, because the investment survey now covers more firms than last year. Even so, investment is still growing too fast.

New restrictions on property lending have halted some developments in Shanghai and Beijing, but the bubble at the luxury end of the housing market continues to inflate: Shanghai property prices surged by 28% in the year to the first quarter, while average prices nationwide rose by almost 8%. Many Chinese are investing in a second home as a way to diversify their savings portfolios, since they cannot invest overseas. There has also been speculative buying by overseas Chinese investors.

Almost everybody now agrees that the economy is growing too fast. The key question is: will China's economy slow gently or will it crash? The hotter the economy gets, the greater the risk of a hard landing, and a repeat of 1994-95 when a previous investment bubble popped, leaving a hangover of excess capacity and deflation that lasted for several years.

However, Hong Liang, an economist at Goldman Sachs in Hong Kong, thinks that talk of a hard landing is premature, because there are several differences between today and the early 1990s. Policy has been tightened sooner this time. In 1993 inflation was already 15% (it rose to 28% at its peak) before the central bank tightened, while money-supply growth then was twice as rapid as today's. In the early 1990s, real interest rates were negative, falling at one point to minus 13%. Today, bank lending rates are positive (see chart). Even so, the level of 5.3% is far too low for an economy where nominal GDP is growing at around 15%.

A second difference is that unlike a decade ago, there has not been a consumer-spending binge. Private consumption grew by only 6% last year, compared with average growth of 14% in 1992 and 1993. That is one reason why last year China had a current-account surplus; in 1993 it had a deficit of 2% of GDP.

The debate over the extent to which China's economy is overheating is sometimes a bit confused. The term “overheating” is normally used when an economy is suffering from excess demand, which then causes inflation to rise. But China's boom has been led by investment, which means that supply is booming as well as demand. As a result, the biggest risk to the economy is not inflation, but overinvestment. A glut of property or industrial capacity could depress profitability, bankrupt firms and swell banks' non-performing loans.

China's banking system, which is virtually all state-owned, does not allocate credit efficiently, and the misallocation of funds gets worse as growth speeds up. Bad debts may already be 40-50% of loans. In the long run, to improve this China needs to commercialise its financial system. That will require financial reform, as well as a transformation in corporate governance. But that will take years. Right now, the government needs to slow the economy to avoid another wave of bad loans.

Turbulence ahead

The measures taken so far have lacked teeth. The People's Bank of China is therefore likely to raise interest rates and to introduce further, stricter quantitative measures to curb lending to the hottest sectors. The recent rash of announcements suggest that the government is starting to panic. The longer the economy grows at its current pace, the greater the risk of a hard landing, which would push up unemployment—something which Beijing cannot afford because of the risk of social unrest.

What do economists mean by a hard or a soft landing? In developed economies a hard landing implies negative growth, but not in China, where growth has averaged 9% over the past two decades. A soft landing would be growth slowing from its current 10% to not much less than 7%, the minimum needed to create enough jobs to absorb surplus rural labour and workers laid off by state-owned firms. Even that could still imply a halving in the rates of growth in industrial production and investment. A hard landing means growth significantly below 7%. Official figures suggest that growth after the early 1990s boom never dipped below 7%—a perfect soft landing. But many economists reckon that growth really slowed to 3-4%.

Some economists draw analogies between China and Thailand before its financial crisis in 1997-98. Investment in Thailand also surged to more than 40% of GDP. The big difference is that Thailand had a current-account deficit of 8% of GDP in 1996. In contrast, China had a surplus of 2% of GDP last year, because its saving is even larger than investment. If China were running a large deficit, its currency would now be under severe downward pressure given all the concerns about its economy. Instead its foreign-exchange reserves are building up because of strong capital inflows, driven by speculation that it will have to revalue its currency.

Indeed, the undervalued yuan is one important cause of China's credit boom and rising inflation. China's capital controls are porous, and investors all over Asia are betting on a currency revaluation by buying property in Shanghai or Beijing or putting their money into yuan deposits to take advantage of interest rates higher than the paltry level available in America. The yuan has been more or less pegged against the dollar since 1995. If, as a result of capital inflows, there is an excess supply of foreign currency, the central bank must buy it and sell yuan to keep the exchange rate stable. This injects new liquidity into the banking system, thereby feeding the credit boom. The central bank has been issuing bonds to mop up the liquidity, but this “sterilisation” is getting harder as the amounts swell. The bank has had trouble selling enough bonds in recent months, so the money supply continues to surge.

China's pegged exchange rate is not only causing problems at home. America accuses China of stealing jobs by keeping the yuan artificially low. In fact, it is not so clear that the yuan is undervalued. On the basis of purchasing-power parity (ie, relative prices) it does look undervalued. But almost all poorer countries look cheap by this gauge, and over the past decade China's real exchange rate has risen. Andy Xie, an economist at Morgan Stanley, calculates that, in real terms, the yuan has risen by 40-50% against both the dollar and the euro since 1993.

But what about another apparently telling piece of evidence: China's huge trade surplus with America? This, argue American politicians, proves that the yuan is undervalued. In fact it does not. China's overall trade balance was in deficit in the first three months of this year, thanks to strong import growth.

A third argument is that China's large surplus on its basic balance (the sum of the current-account and net foreign direct investment) and its huge build-up of foreign reserves are both symptoms of currency undervaluation. Mr Xie again disagrees. The increase in reserves, he argues, partly reflects speculative capital inflows. Moreover, if the capital account was opened (which is unlikely over the next four or five years), allowing firms and households to hold foreign assets, the yuan would probably fall, not rise, as the Chinese diversified their savings.

These arguments help to explain why the Chinese have so far ignored American demands to revalue their currency. It is not just crude mercantilism; there is much uncertainty about the yuan's correct value. The Chinese government says it will move towards a more flexible exchange rate in the medium term, but for the moment it wants to keep the yuan stable in order to support broader economic stability. Yet in fact, a flexible exchange rate can offer more stability, partly by providing a safety valve which helps to protect the real economy.

The strongest argument for a revaluation now is not that the yuan is undervalued, but that an adjustment would halt speculative capital inflows and so mop up the excess liquidity. It would be unwise for China to float the yuan until it has cleaned up its banking system, but it could repeg against the dollar at a higher rate and shift to a currency basket, which is what the government has said it would like to do. The snag, however, is that a small revaluation of only 5% might encourage expectations of a further appreciation and attract more capital inflows. Any revaluation would need to be large enough, say 10-20%, to head off such speculation. But a rise of such proportions would be unacceptable to the government, so the yuan is likely to remain fixed for the moment.

If so, the normal weapon to cool an overheating economy, higher interest rates, is likely to prove partly self-defeating in China because a rise in interest rates would lure in yet more hot money. Besides,

interest rates play a modest role in an economy in which credit is allocated with little regard to its price. Despite China's reforms of recent years, the government still controls more than half of the economy. Most state-owned enterprises do not care about the cost of borrowing because they have no need to make profits. Local-government construction, a key feature of the investment boom, also remains unaffected by the cost of money, so long as credit is freely available. Higher interest rates will have the biggest impact on home mortgages and consumer loans. Yet the mortgage business is small, and consumer spending has been relatively weak.

Another way to slow the economy is fiscal tightening. The government says that it plans to trim its budget deficit slightly from 2.9% of GDP in 2003 to 2.5% this year. But if Beijing were truly worried about the economy overheating then surely it could cut public investment and run a budget surplus? Unfortunately, nothing is so simple. Unlike a developed-market economy, China lacks effective tools to fine-tune demand. Just as the interest-rate tool is weak, so fiscal policy is hampered by socio-political factors. That leaves the central bank with quantitative controls as its main policy tool. The risk with such crude measures is that it is easy to overdo things and cause a more severe contraction than intended.

Short-run gloom, long-run boom

The recent pace of China's growth is unsustainable and the rest of the world needs to prepare itself for slower growth and weaker import demand from China over the next year or two. Over the past five years China has accounted for one-quarter of global GDP growth (measured at purchasing-power parity). But even if China's economy does suffer a hard landing, that does not mean that the long boom is over.

China faces two separate questions. Will its economy slow significantly over the next few years? And can China sustain rapid growth for another couple of decades? The answer to both questions might be yes.

Despite some hiccups along the way, the East Asian economies, such as South Korea and Taiwan, sustained average growth rates of around 8% for four decades. China's boom started barely two decades ago, and its income per head is still relatively low, so it has huge potential to improve efficiency and catch up.

What is China's sustainable growth rate? That is much trickier to answer than it would be for a developed economy such as America's. China's economy is not limited in the same way by the supply of labour or capital. It has a vast pool of surplus labour in the countryside, and masses of capital thanks to unusually high domestic saving and inward foreign direct investment. There is also massive scope for productivity gains as workers move from low value-added agriculture to higher-value activities. In theory, this could allow China to sustain growth of 8% for another two decades. In practice, the limiting factor will be the inability of its financial system to allocate capital efficiently until it carries out financial-market reforms.

Some economists who are downbeat about China's long-term prospects argue that its inefficient investment will drag down future growth. According to official figures, China's investment of 47% of GDP is much higher (and hence possibly more wasteful) than that in the other East Asian economies at the same stage of their development. A popular economic measure is the incremental capital-output ratio (ICOR) which divides annual investment by the annual increase in GDP. China's ICOR has risen from three in the 1980s and 1990s to an average of more than 4.5 over the past five years. In other words, to get an extra $1 of output, China now has to invest $4.50 compared with only $3 in the past. This, conclude many economists, means that the return on investment has slumped. Worse still, by this test, China's investment is even more wasteful than in India, which has an ICOR of four.

Such conclusions may be overly gloomy, because the ICOR is flawed as a measure of the efficiency of investment both over time and between different countries. The ratio automatically rises as an economy develops and shifts to more capital-intensive production. In America, it is currently seven, and it is hardly surprising that India, which is less developed than China, has a lower ratio. A second problem is that the ratio is calculated using gross investment, ignoring depreciation of the capital stock. A large slice of investment in China has been to replace the poor-quality industrial base created during its command-economy era. Net investment has been lower.

Another reason for the apparent rise in China's ICOR has been a big increase in infrastructure investment: roads, ports and housing. This tends to distort the ratio upwards in the short term, because the money is spent now, whereas the returns are spread over many years. The Chinese have been allowed to buy their own homes only since 1998 and this has caused a big increase in construction as people have demanded better housing in place of the overcrowded flats they used to live in. The

unprecedented shift of people from the countryside to cities also requires greater infrastructure investment than in other emerging economies.

Jim Walker, an economist at CLSA, a securities firm in Hong Kong, also reckons that official figures overstate investment. Unlike in other countries, the official measure of investment does not appear to be constructed on a value-added basis like GDP. It includes all land sales, regardless of whether they involve new development. Also, local officials, who are rewarded according to their achievements, have an incentive to overstate investment. Correctly measured, Mr Walker reckons that investment is closer to 30% of GDP.

Ms Liang, at Goldman Sachs, has tried to calculate the efficiency of investment in manufacturing, where investment and output are easier to measure. She finds that the return on such investment has actually risen over the past decade. Likewise, Merrill Lynch reports that the total profit of industrial firms as a share of revenue has risen strongly over the past decade.

Various studies confirm that China's productivity growth has increased. Total factor productivity (the efficiency with which both labour and capital are used) has been rising at an average annual rate of 2-3% a year. That may not sound much, but it is faster than in the East Asian tigers at the same stage of their development. During 1960-84 their total factor productivity growth averaged only 1%.

China's current pace of growth in investment is unsustainable. Its combination of a badly functioning banking system, excessively cheap money and heavy government meddling is bound to result in some bad investment decisions. It would be wrong, however, to dismiss most of China's investment as wasteful. And even if China's current investment boom turns to bust, it would be foolish to write off China's economic future.

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Financial markets

The bonds from Brazil

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Markets everywhere have fallen as the day nears when the Federal Reserve raises rates. Hardest hit have been emerging-market bonds

APART from citizens of Brazil and the rarefied folk that deal in international bonds, few will have heard of, much less care about, that country's dollar-denominated 11% bond, which matures on August 17th 2040. In fact, it is rather important. Since this is the country's benchmark bond and Brazil is the biggest debtor among emerging countries, it has become the benchmark bond for all emerging markets. Even by the exacting standards of such markets, Brazil's 11% '40 is stomach-churningly volatile. As a much-favoured play for investors fleeing small yields on American Treasuries, the price of the bond rose from 43 cents per dollar of face value in late 2002 to 120 cents in January, dragging yields from 26.7% to 9.5%. Since then the bond's price has fallen by 30% or so, and this week touched a low of 83 cents.

On top of domestic wobbles, the proximate cause of this latest fall in the Brazilian benchmark were worries that, as result of a series of strong economic statistics from America—the latest being robust employment numbers—and inflationary stirrings, the Federal Reserve will put up interest rates much sooner than the market had expected. It now thinks they will rise in June. The yield on ten-year Treasury bonds, which had fallen to 3.65% in March, climbed at one point this week to 4.8%.

Though extreme, the reaction of the Treasury-bond market (and other bond markets) to the threat of higher interest rates and creeping inflation was predictable enough. Less predictable, perhaps, has been the sharp fall in the price of riskier assets the world over.

Investors' biggest worry is that a rise in American rates will withdraw a crucial support from the many markets around the world that had risen vertiginously, helped up by the many who had wanted more bang for their buck than could be gained from popping it in the bank. Their fears have been doubled because many of these, hedge funds being the most obvious, had taken advantage of ultra-cheap borrowing to leverage these bets.

Betting with borrowed money worries many because, although it allows investors to make more when markets go their way, it multiplies their losses when they do not. Enforced liquidation—or the fear of it—has been partly responsible for markets' skid in recent weeks. That, after all, was what happened in 1994 when the Fed last raised rates sharply. And in 1998, Russia's default led to the near-collapse of Long-Term Capital Management, a hugely leveraged hedge fund, and caused huge losses for other leveraged investors.

These fears have been the main reason why stockmarkets have fallen lately—although spurting oil prices (see article) also frightened investors this week. America's S&P 500 is now down 5% from its recent high. European shares, too, have stumbled: the Eurotop 300, an index of the shares of leading companies, is 5.5% off its peak. Japan's Topix index, which had been driven up entirely by foreign buying in recent months (domestic investors have been selling all the way up) is now 8% below its high; on May 10th alone, it fell by almost 6%, before perking up later in the week.

These falls pale, however, when compared with those in emerging markets. An index of emerging-market shares compared by Morgan Stanley Capital International has fallen by about 16% from its peak in mid-April. In part, these woes reflect fears that China's demand for commodities, and hence commodity prices, will falter. If this happens, economies that rely on commodity exports will suffer. Stockmarkets in countries where interest-rate and commodity-price fears are combined, as they are in Latin America, have done especially badly. Argentina's and Brazil's are both down by a quarter from their highs.

And then there is emerging-market debt. As a uniquely poisonous cocktail, mixing fears of rising rates with high leverage and silly valuations, the market for such bonds is hard to beat. Last year, investors, especially leveraged ones, piled into emerging-market bonds as a splendid way to pick up yield. But as worries that rates will rise have mounted, a fall over the past few months has turned into a rout as the hot money has scrabbled to get out.

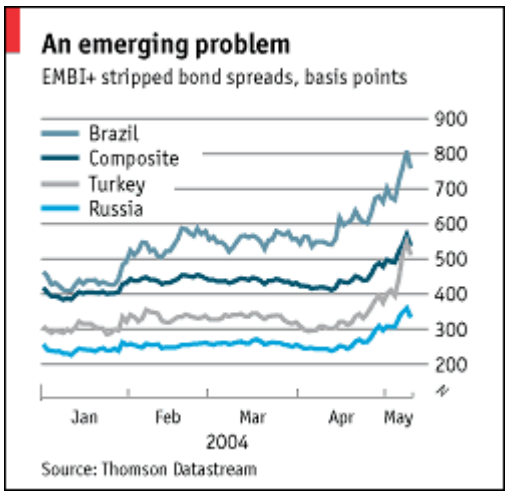
Déjà vu all over again

Anyone who buys the foreign debt issued by emerging countries takes two separate, though linked, punts. Since most bonds are denominated in dollars, what happens to American Treasury-bond yields has a big impact on their prices. But so do perceptions of how likely their issuers are to default. This risk is measured by the spread—dubbed the credit spread—that these bonds offer over Treasuries: the greater the risk, the higher this is.

Last year, the big money was made from falling credit spreads. From its peak in September 2002 to its trough early this year, the EMBI+, an index of these spreads tracked by J.P. Morgan, fell from 1,041 bps (basis points, or hundredths of a percentage point) over Treasuries, to 384 bps in early January.

This is a little curious. None of the top borrowers in emerging markets has an unsullied credit record. Brazil, the biggest borrower, defaulted in 1826, 1898, 1902, 1914, 1931, 1937 and 1983. Its neighbour, Argentina, another serial non-payer, is still in default to the tune of $100 billion or so, the biggest in history. Russia last defaulted (admittedly, only on its domestic debt) in 1998. Moreover, the riskiness of these issuers has fallen only slightly over the past year. Russia has benefited from high oil prices, and Latin American economies have been given a fillip by rising commodity prices. But the credit-worthiness of emerging-market issuers overall has not markedly improved.

True, yields were probably too generous in the autumn of 2002. But by the turn of this year they were ludicrously meagre, given the risks that investors run by lending money to countries with a habit of not repaying it. Prices have dropped since then, not only because Treasuries have fallen but also because credit spreads have widened dramatically as investors wake up to these risks. The spread of the EMBI+ rose from its low point in January to 569 bps this week.



Though prices subsequently recovered a bit, emerging debt probably has further to fall. The Fed's drip-feed of low interest rates and investors' ravenous appetite for risk enabled many emerging countries and companies in them (notably, Russian firms) to borrow remarkably cheaply in the capital markets, despite a multitude of deep-seated problems.

As interest rates wax and risk appetite wanes, investors are likely to focus on countries' problems, not their progress. Christian Stracke, an analyst at CreditSights, an independent bond-research firm, points out that many countries—Brazil, Turkey, and the Philippines among them—still need to borrow lots from abroad this year to finance their deficits. Indeed, he points out that at some $40 billion, Brazil's foreign-borrowing needs for the rest of this year are greater now than the $37.5 billion that it needed at the same stage of 2002. The 11% '40 will prove a good measure of investors' appetite.

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Oil prices

Frothy

May 13th 2004
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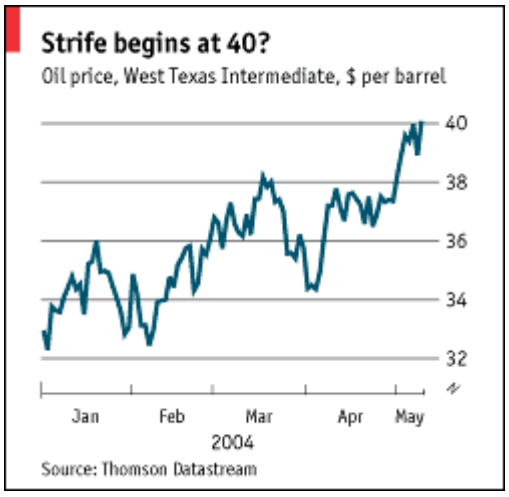
Can the Saudis cool the overheating oil markets?

NOT much is predictable in the oil world. One thing is usually certain, however: when Saudi Arabia speaks, the market listens. And when it promises more oil, prices usually fall.

Consider, though, this week's events. On May 10th, Ali al-Naimi, the Saudi oil minister, vowed to press the Organisation of Petroleum Exporting Countries (OPEC) to increase quotas by at least 1.5m barrels per day (bpd) at its next formal meeting in June. He clearly hoped to talk oil prices down from around $40 a barrel. They duly dipped—but then surged to a 13-year high (see chart).



Mr al-Naimi failed because soaring demand, tight supply and growing concerns about terrorism have combined to drive prices up and keep them up. Take demand. A lot of coverage has focused on China, yet the International Energy Agency's monthly report, released on May 12th, cited OECD countries as the chief cause of its upward revision of demand. This week America's Department of Energy (DOE) also increased its estimate of world demand for 2004.

Meanwhile, the supply picture looks dicey, thanks to OPEC. It seems that the cartel cut output last month by around 400,000 bpd, with the Saudis leading the way. Traders want tankers on the water, not promises. Their scepticism explains why the cartel's ministers may agree new quotas next week, when they meet informally in Amsterdam.

The wild card is the spectre of terrorism. Iraq's northern export pipeline has come under frequent attack. Now the raids are spreading to the south, source of perhaps two-thirds of Iraqi output. One knocked out about 400,000 bpd of output; an audacious attack on port facilities apparently failed.

And if you want to see traders panic, just mention Saudi Arabia and terrorism in the same sentence. The Saudis sit atop a quarter of the world's reserves, export more oil than anyone else and are the only producers with enough spare capacity to deal with emergencies. The DOE said this week that only once in the past 30 years has global spare capacity been lower. Saudi oil facilities are now being targeted. A serious attack on the kingdom's oil infrastructure scarcely bears thinking about.

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Trade

From Cancún to can-do

May 13th 2004 | BRUSSELS AND WASHINGTON, DC
From The Economist print edition

The European Union tries to revive the Doha round of trade talks

PASCAL LAMY, the European Union's trade commissioner, is sometimes nicknamed the Dalai Lamy. As well as being a juvenile play on his name, the moniker is a tribute to his shaven head and alleged asceticism. Fortunately for the world economy, Mr Lamy seems disinclined to apply the Buddhist virtue of infinite patience to the Doha round of world trade talks.

The round seemed to have collapsed in Cancún last September, when a deep division emerged between poor and rich countries about both the scope of the talks and the extent to which rich countries' farm support should be cut. The EU was at the centre of the furore. Now Mr Lamy has made an offer that he hopes will help get everybody back to the table. Encouragingly, his proposal has been warmly welcomed in the United States, cautiously welcomed in the developing world and roundly condemned in Mr Lamy's native France.

The reason for his compatriots' ire is that France is the biggest single recipient of the EU's farm aid and Mr Lamy has offered to eliminate all export subsidies on farm goods, a concession the Union long resisted. This offer is not quite as dramatic as it sounds. Export subsidies account for just €3 billion ($3.6 billion) of the €45 billion a year that the EU lavishes on subsidising and protecting farmers. What is more, they are already being phased out: in 1992, they amounted to €10 billion. Mr Lamy's offer is not even unconditional. He says the EU's proposal will stand only if the Americans, Australians and Canadians cut back on their own equivalents of export subsidies.

Still, his offer has some merit. Export subsidies from rich countries do particular damage to the farmers of the developing world. And the fact that the EU has finally acknowledged that they must go could get talks restarted. Mr Lamy has also modified the EU's ambitious demands on the scope of the trade talks, which had proved a serious problem in Cancún. The EU wanted to bring four topics—trade facilitation, investment, competition and public procurement—within the ambit of world trade negotiations. Mr Lamy now accepts that he made a tactical error in pushing these “Singapore issues” too hard. His new position is no longer that all these topics must be dealt with. They can be addressed one at a time and need be included in the Doha round only if “there is consensus to launch negotiations” on them.

Mr Lamy's latest gambit has injected some much-needed optimism into the world trade round. But this new mood could quickly fade. In both Brussels and Washington, officials agree that the broad outlines of a deal on agriculture need to be in place by July—or the whole round will have to go on hold until after the American presidential election.

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Citigroup

Rainy day

May 13th 2004 | NEW YORK
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Citigroup settles a class-action suit with WorldCom shareholders

EPA

THE bill is enormous, but it might have been even higher. Before financial markets opened on May 10th, Charles Prince, the chief executive of Citigroup, told analysts that his bank, easily the world's biggest by market capitalisation, would pay $2.7 billion to settle class-action litigation accusing it, in essence, of fraudulently misleading investors in WorldCom with tainted research in the bubble years. Billions more, Mr Prince added, would be put aside as a reserve against hundreds of other lawsuits, of which the most significant are tied to Enron.

Citigroup's total bill for bubble-related litigation has reached $9 billion, estimates Michael Mayo, an analyst with Prudential Securities. The WorldCom sum alone, another analyst pointed out to Mr Prince, is extraordinary if, as the chief executive insists, Citigroup has done no wrong. Indeed: it is almost twice the total paid by ten Wall Street firms (including Citigroup) last year in a settlement with regulators over skewed bubble-era research.

But not as much, replied Mr Prince, as Citigroup might have had to pay. He said that courts have become tougher places for corporate defendants in the past year and a half. This week's settlement was concluded hours before a federal appeals court was due to begin considering an important phase of WorldCom litigation. It would ponder, among other things, whether Citigroup, a prominent booster of WorldCom's shares, could be held responsible for investors' losses. According to the “fraud on the market” theory pushed by the plaintiffs, because share prices are shaped by information, those who distribute false information are liable for the losses of anyone who bought shares when it was circulated, whether they knew about it or not.

Lower courts have split on whether this theory, which has so far been accepted only for companies' statements about their own finances, can also be applied to investment banks' research. However, Mr Prince said Citigroup had been hurt by the Securities and Exchange Commission's submission of a brief supporting the notion that it could. Defeat in court could have cost $54 billion. “I was not willing to roll the dice,” said Mr Prince, preferring to forgo roughly a quarter's earnings.

Settling brings benefits to Citigroup beyond limiting losses. Because it has chosen to avoid the risk of losing in court, the bank can continue to say it has broken no laws. It says it can also set the cost of the settlement against tax, passing about one-third of the bill on to the public. A trial might have shown Citigroup in an unflattering light even if it had won. Its relationship with WorldCom and its deposed chief executive, Bernie Ebbers, would have been made plain. So would the ways in which the bank made money while those who bought WorldCom shares, at times with Citigroup's encouragement, lost their shirts. Much attention would doubtless have been paid to the role of Jack Grubman, the bank's former telecom analyst: a huge fan of WorldCom, he worked closely with its management. Last year Mr Grubman paid a $15m fine after e-mails surfaced suggesting that he often was far more critical of companies than his published opinions revealed.

The settlement was a “wake-up call to those on whom the investing public depends to guard against corporate corruption,” said Alan Hevesi, comptroller of New York state, who acted as lead plaintiff. Mr Hevesi is trustee of the state's public pension fund, which lost $306m on investments in WorldCom. Settlements with the 17 other underwriters of WorldCom debt, if structured according to the same formula, could lead to the recovery of an additional $2.8 billion. Mr Hevesi's office cannot say how this

formula is composed.

Nor can it say how much of this week's settlement will go to the state pension fund—other than that the amount will not be large. As a shareholder, the state pension fund (along with other plaintiffs) will have lost money when Citigroup's shares slid on news of the settlement. The two law firms representing the plaintiffs are likely to do rather better. The firms' percentage of the settlement, set out in an agreement signed last July and in the public domain, is between 5% and 6%. That is not inordinately high by class-action standards, but the sum still works out to a whopping $144.5m.

That is more than Citigroup earned from underwriting securities for WorldCom. Other Wall Street banks will surely take note of this—and of the sheer scale of Citigroup's provisions—and worry.

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About sponsorship

German retail banks

Rocking the boat

May 13th 2004 | FRANKFURT
From The Economist print edition

The planned IPO of Postbank is not all plain sailing

Still floating

AN ELEGANT three-masted schooner in the colours of Postbank, the banking arm of Germany's post office, is making its way slowly from Cologne up the Rhine and Main rivers, to reach Frankfurt on June 21st, the date of the bank's initial public offering (IPO). The short voyage is still likely to be completed, despite a stormy week in which, under clear pressure from the government, Deutsche Bank, a lead manager of the IPO, agonised over making an outright bid for Postbank.

Deutsche's management board met on May 11th; apparently, an offer for Postbank was on the agenda. Deutsche refused to comment afterwards. So would there be no bid after all? Privately, it protested that it was simply waiting for the government, which owns more than 60% of Deutsche Post, Postbank's parent, to decide whether to change the terms of the sale. On May 13th, Deutsche Post insisted that the IPO would go ahead as planned.

The government seems to have spotted that a block sale of Postbank, Germany's most successful retail bank, with 11.5m customers and roughly 6% of bank deposits, to one of the big four private-sector banks, would give the consolidation of the country's banking industry a helpful shove. Even Deutsche, Germany's biggest bank, has maybe 5% of retail deposits. A tie-up with Postbank would give it a half-decent slice of the market, plus the chance to sell more products to Postbank's customers.

The trouble is, the government reached this conclusion a little late in the day. Gerhard Schröder, the chancellor, made a rare intervention on May 5th, calling for consolidation that would produce, before June was out, “a global institution to be taken seriously inside and outside Germany”. Nobody doubted that he meant Deutsche Bank.

Unfortunately, selling control of a government-owned institution cannot be urged by a chancellor one day and executed the next. A block sale would have meant a radical change of plan. Under the IPO, just under half of Postbank will be sold: a block-buyer would need 75% to exercise untrammelled control. Such sales are hedged about with rules on tendering and fair competition, not to mention Deutsche's conflict of interest as both IPO-manager and potential block-buyer.

Deutsche was the most obvious German buyer. Besides being the biggest bank, it has the required €6 billion ($7.1 billion) or so in ready cash. However, Commerzbank, another of the top four, which got close to a deal with Postbank in 1998, showed interest; so, reportedly, did France's Crédit Agricole and Generali, an Italian insurer. Some fear, though, that buying Postbank might distract Deutsche from its global aims, particularly in investment banking; Deutsche has denied that the mooted bid has caused an internal rift. One investment banker says that the dream combination would be Deutsche Bank and Allianz, a big insurer that already owns Dresdner Bank, another big bank. This, he muses, might create a true German giant. But it would be fraught with difficulty—notably, determining the fate of Allianz's investment-banking subsidiary, Dresdner Kleinwort Wasserstein.

Despite Mr Schröder's matchmaking efforts, Postbank's IPO will probably go ahead. Indeed, the government, having seemed so keen on consolidation, is now keeping quiet. Why? There is one rumoured explanation: that in a secret deal with the unions in 1998 Deutsche Post promised not to cede control of Postbank for ten years. Maybe in 2008?

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Bank regulation

Now for the hard part

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Agreement has been reached on new bank-capital rules, but work lies ahead

ON MAY 11th, after almost five years of hard work and negotiation, the Basel Committee of bank supervisors reached agreement on new international rules for bank capital. Called Basel 2, the rules aim to link capital more closely to the riskiness of banks' assets than existing regulations do. Like the old system, Basel 2 requires capital to be at least 8% of “risk-weighted” assets. However, whereas the old system of weighting was pretty crude, the new one will be fiendishly complicated. In addition, national supervisors will have discretion to adjust capital requirements, and banks will be expected to disclose more information to investors.

From the end of 2006, the original deadline, the rules will apply to smaller, less sophisticated banks—but not in America, where only big, international banks will be subject to Basel 2. Such banks won an extra year in which to comply. They are allowed to use their own internal risk-models to calculate their capital requirements. American regulators complained that the rules for these models needed more work.

Even now, it is uncertain that American banks will meet the delayed timetable. John Hawke, head of the Office of the Comptroller of the Currency, one of America's many bank regulators, says that an “extensive process” remains before Basel 2 can be adopted, including input from Congress and a fourth “quantitative impact study” (Europeans made do with three).

In Europe, where it is intended to apply Basel 2 to all banks, no matter how small, implementation will proceed in two phases. Here too, politics might cause delays. The European Parliament must approve the new system, and there are elections in June. Critics worry that those banks that adopt the rules early will be at a competitive disadvantage.

But the biggest challenges likely lie elsewhere. Thus far, most of the work on Basel 2 has focused on “pillar 1”, the complicated formulas used to assign risk weightings to a bank's various assets, from credit-card debts to government bonds. But pillar 2, which allows national regulators the discretion to tweak regulatory capital levels, and pillar 3, which compels banks to disclose much more information to financial markets, are likely to have a much bigger effect on capital requirements and banks' behaviour, says Christian Pederson of Mercer Oliver Wyman, a consultancy. Much of the relevant work lies ahead.

Pillar 2, in particular, is tricky. Big, multinational banks with offices in dozens of countries worry that the latitude given to national regulators could lead to a fiddly patchwork of rules. Others fret that some national regulators are not capable of supervising big banks adequately. “Basel 2 is incredibly complicated, as are big banks' risk models,” says one consultant. “Checking boxes won't be enough.”

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Economics focus

The stuff of life

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In the fifth of a series of articles on the Copenhagen Consensus project*, we look at water and sanitation

HUNDREDS of millions of poor people around the world lack access to two services that people in rich countries take entirely for granted: clean water and basic sanitation. According to a study by Frank Rijsberman, director-general of the International Water Management Institute in Colombo, Sri Lanka, improving the delivery of clean water and sanitation to the poor would be a highly cost-effective way to use additional aid to developing countries. His paper, “The Water Challenge”, was commissioned as part of the Copenhagen Consensus project, which this column has followed in recent weeks. It spells out the benefits that additional spending on water and sanitation could bring, and sets these against the comparatively modest costs.

The global “water crisis” that development economists and environmentalists often refer to is really two distinct problems, says Mr Rijsberman. So far as the supply of water for domestic purposes is concerned, there is plenty to go around: domestic uses such as drinking, cooking and cleaning make relatively tiny demands on available supplies, and are generally given first call in any case. The problem is one of delivery: in many poor countries available supplies very often fail to reach the poor. Separate from this question of the distribution of water is the issue of long-term management of the resource. This arises because supply must also meet the demand for water for productive purposes, notably farming, and these use vastly larger quantities of the stuff. Again, where supplies fail to get through, it is usually the poor who suffer most.

The global burden of illness owing to dirty water, bad or non-existent sanitation and poor standards of hygiene is remarkable, according to the studies cited by Mr Rijsberman. It has been estimated that “at any given time, close to half the population in the developing world are suffering from one or more diseases associated with inadequate provision of water and sanitation services: diarrhoea, ascariasis, dracunculiasis (guinea worm), hookworm, schistosomiasis (snail fever) and trachoma.” According to one study, there are about 4 billion cases of diarrhoeal disease a year, resulting in between 1m and 2m deaths, 90% of them among children under five. Diarrhoeal diseases account for between 40m and 80m disability-adjusted life years (or DALYs, the standard measure of the burden of disease: in effect, the number of years of healthy life lost to illness, weighted by the severity of the disease and other factors).

To apply cost-benefit analysis to the question, it is necessary to attach a value to a DALY—which is difficult. A value of $500, in line with the annual income of a poor person living in a poor country, implies a cost ranging up to $40 billion a year. Applying a much higher figure for the value of a DALY, one consistent with the incomes of the not-so-desperately poor, would be easy to defend (and is the approach adopted by the Copenhagen Consensus paper on communicable diseases, for instance). This would yield correspondingly higher costs associated with illness due to poor supplies of water and sanitation.

The United Nations' Millennium Development Goal for water and sanitation is to halve the numbers lacking access to basic supplies by 2015. To meet this goal, some 1.5 billion people worldwide will by then need to have been granted access to clean water, and some 2.1 billion access to adequate sanitation. When it comes to design of the projects, past experience, argues Mr Rijsberman, suggests that local management is very important for the success of any new investments. Another lesson has been that improving sanitation gives even better value for money than improving the delivery of water. Mr Rijsberman also underlines the case for using low-cost technologies, such as standpipes for water supply, pit latrines for sanitation in rural areas and cheap sewerage systems for sanitation in urban areas.

Cool and clear

In sub-Saharan Africa, the annual cost of supplying water and sanitation in this way to half of those currently lacking them would be around $2 billion; the benefits of sanitation alone (for which more detailed estimates are available, and which yield the larger part of the benefits in any case) might be some $16 billion a year. This suggests a conservatively estimated ratio of benefits to costs of eight. The present value of the total net benefit for sub-Saharan Africa would be around $130 billion using a discount rate of 5%, and around $100 billion using a rate of 10%. For the developing world as a whole, the corresponding figures are these: annual cost of improving access to water in line with the Millennium Development Goal, $1.7 billion; cost of improving sanitation, $9.3 billion; annual benefits from improved sanitation alone, $55 billion; ratio of sanitation benefits to total costs, five; net present value of this course of action, $400 billion using a discount rate of 5% and $312 billion using a rate of 10%.

In designing such an initiative, Mr Rijsberman notes the interaction between the challenge of improving water and sanitation services and other development issues, notably the resolution of conflicts, discussed in another Copenhagen Consensus paper. Success in the one will often depend on success in the others. Plainly, this complicates the setting of development priorities. At the end of this month, the experts and Nobel laureates assembled to undertake that very task will get down to business. We will report on their conclusions in due course.

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* The Copenhagen Consensus project, organised by Denmark's Environmental Assessment Institute with the co-operation of *The Economist*, aims to consider, and to establish priorities among, a series of proposals for advancing global welfare. The initiative was described in our Economics focus of March 6th. That article can be read here, along with other material, including an Economics focus on trade policy, published this week online only. A book, "Global Crises, Global Solutions", containing the full set of papers written for the project is forthcoming from Cambridge University Press.

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About sponsorship

The end of the Permian

Bang and blame

May 13th 2004
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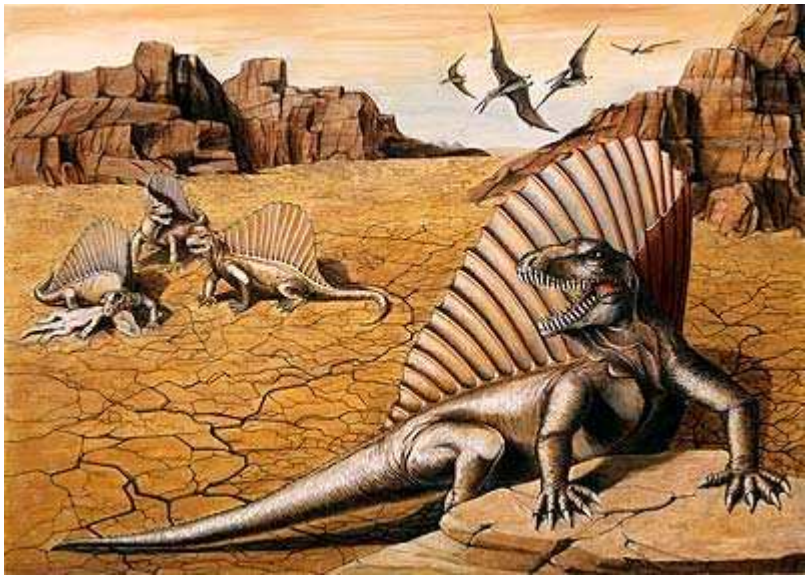
Ardea



The mystery of the biggest mass extinction in history has been solved. Or has it?

MARKETING is everything. Dinosaurs were introduced to the public in the 1850s, when life-size models of them were used to decorate the most popular tourist attraction in the world—London's Crystal Palace. The “Bone Wars” between Edward Cope and Othniel Marsh, to transport dinosaur fossils from the quarries of the newly opening American west to the museums of the established east, gave them wealthy sponsors, such as Andrew Carnegie. And the creatures' spectacular lives were rounded with a spectacular death when it was demonstrated to the satisfaction of most palaeontologists that they were wiped out by a collision between the Earth and an asteroid. A storybook ending to a storybook existence. For many people, dinosaurs *are* prehistoric life.

Yet the extinction of the dinosaurs at the end of the Cretaceous period, 65m years ago, though accompanied by that of many other creatures at the same time, was not the biggest die-off in world history. That distinction belongs to the end of the Permian period, some 250m years ago. The end of the Permian was marked by the extinction of 90% of the Earth's species. They may not have been as spectacular as the dinosaurs, but they included some noteworthy reptiles, such as the sailback *Dimetrodon* illustrated above.

The end of the Permian was once thought of as a whimper to the Cretaceous's bang. It was believed to have been caused by a slowly drying climate that was the result of continental drift bringing all of the Earth's land together into an enormous supercontinent. But this feeling changed when evidence of huge volcanic eruptions, known as flood basalts, was discovered. Flood basalts also marked the end of the Cretaceous—they form the Deccan Traps, in central India. Now, the other element of the demise of the dinosaurs has turned up at the end of the Permian. A paper in this week's *Science* purports to identify an impact crater as big as the famous “dinosaur killer” at Chicxulub, in Mexico. The “sailback killer”, if that is what it was, smashed into the Earth in north-western Australia.

Shattered evidence

Luann Becker, of the University of California, Santa Barbara, and her colleagues, the authors of the

paper, have been stalking the sailback killer for years. In 2001, they reported finding fullerenes in rocks from the end of the Permian. Fullerenes—familiarly known as buckyballs, after Richard Buckminster Fuller, an architect whose geodesic domes they are alleged to resemble—are cage-like molecules made of carbon atoms. The cages can trap inert gases such as helium and argon, and when Dr Becker analysed the weights of the helium and argon atoms from her late-Permian fullerenes, she found that the mixture resembled that of gas from meteorites, rather than from the surface of the Earth.

Many people were sceptical. They pointed in particular to the absence of iridium in the rocks in which the fullerenes were found. The presence of iridium—a metal rare at the surface of the Earth, but relatively abundant in meteorites—was the first clue pointing towards the dinosaur-killing impact.

Last year, however, the researchers reported more evidence. They had been working in Antarctica, and had found what they believed were ejecta from an impact. They still did not find any iridium, but they did find fragments of rock that looked like pieces of meteorite. There was a thin layer of a type of rock known as breccia, which forms from the smashed-up material launched out of a crater. And there was “shocked quartz”—crystals of the mineral shattered in a way characteristic of the shockwaves that follow an impact.

All very significant. But not complete proof. For that, a crater of the right age would be required. And this is what seems to have turned up. Argon-argon dating, which relies on the fact that radioactive argon decays into a non-radioactive isotope of the gas at a known and constant rate, suggests the Australian crater is 250.1m years old, plus or minus 4.5m years.

The crater is not visible at the surface. In fact, it is buried under 3km of sedimentary rocks. It was first detected in the 1970s by oil prospectors, who mapped its geometry by listening to the reflections from its various rock layers of explosions they let off at the surface. More detail was worked out later, by precise measurements of gravity above it. Both the size of the structure, and its approximate age, as indicated by fossils in the rocks, suggested to Dr Becker that it might be what she was looking for. Her argon-argon dating of the local breccias has now confirmed that. And these rocks also contained small, glassy spherules, another signature of impacts.

Put together, then, the evidence is impressive. *Dimetrodon* and its cousins do, indeed, seem to have met their fate at the hands of a huge impact, with a background of massive volcanic eruptions, just like the dinosaurs.

Yet there is a niggling worry in all this. Why should flood basalts and asteroid impacts coincide? One possibility is that it is just that—a coincidence. Once, maybe. But twice? (And, indeed, more often than that if evidence of an impact coinciding with flood basalts at a third mass extinction at the end of the Triassic period stands up.) A second idea is that big impacts cause massive eruptions by shocking the Earth so profoundly that its innards get upset. But in the case of the Cretaceous, the evidence suggests that the eruptions started before the crater was formed. So there is the horrible possibility that everybody has got things the wrong way round, and it is the vulcanism that causes the craters.

That, at least, is the theory of Jason Phipps Morgan and his colleagues at Kiel University in Germany. A few months ago they suggested that flood basalts might be accompanied by huge explosions, which they dubbed “Verneshots” because, like the launching gun in Jules Verne's novel “From the Earth to the Moon”, they would be capable of launching things into space.

A Verneshot would, according to Dr Phipps Morgan, produce almost all of the evidence thought to indicate an asteroid strike: iridium (which would be brought up from deep in the Earth), shocked quartz, buckyballs, spherules—and big impact craters caused by the return to Earth of huge gobbets of material the explosion ejected. Meteorite fragments are more difficult to explain. But the Earth is hit by meteorites all the time, so they could be “contamination” from smaller impacts.

At the moment, this idea is mere hypothesis. But Dr Phipps Morgan points to a strange, circular gravitational anomaly buried under the lava of the Deccan Traps. This, he speculates, could be the muzzle from which a Verneshot was fired.

The idea that mass extinctions are caused by impacts from outer space has been one of the best marketed pieces of popular science—it has even inspired Hollywood movies. It would be ironic, indeed, if Dr Becker's Australian crater, on the face of things such eloquent evidence for the extraterrestrial nature of mass extinctions, turned out to be a crucial nail in that theory's coffin.

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About sponsorship

Animal behaviour

Quoth the raven

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Now, it seems, even the bird-brained have theories of mind

HUMANS like to regard themselves as exceptional. Other animals do not have complex, syntactical languages. Nor do most of them appear to enjoy the same level of consciousness that people do. And many philosophers believe humans are the only species which understands that others have their own personal thoughts. That understanding is known in the trade as having a “theory of mind”, and it is considered the gateway to such cherished human qualities as empathy and deception.

Biologists have learned to treat such assertions with caution. In particular, they have found evidence of theories of mind in a range of mammals, from gorillas to goats. But two recent studies suggest that even mammalian studies may be looking at the question too narrowly. Birds, it seems, can have theories of mind, too.

Featherbrains

In the *Proceedings of the Royal Society*, Bernd Heinrich and Thomas Bugnyar of the University of Vermont, in Burlington, describe a series of experiments they have carried out on ravens. They wanted to see how these birds, which are known to be (at least by avian standards) both clever and sociable, would respond to human gaze.

Response to gaze is reckoned to be a good measure of the development of theory of mind in human children. By about 18 months of age most children are able to follow the gaze of another person, and infer things about the gazer from it. Failure to develop this trick is an early symptom of autism, a syndrome whose main underlying feature is an inability to understand that other people have minds, too.

To test whether ravens could follow gaze, Dr Heinrich and Dr Bugnyar used six six-month-old hand-reared ravens, and one four-year-old. The birds were sat, one at a time, on a perch on one side of a room divided by a barrier. An experimenter sat about a metre in front of the barrier. The experimenter moved his head and eyes in a particular direction and gazed for 30 seconds before looking away. Sometimes he gazed up, sometimes to the part of the room where the bird sat, and sometimes to the part of the room hidden behind the barrier. The experiment was videotaped.

Dr Heinrich and Dr Bugnyar found that all the birds were able to follow the gaze of the experimenters, even beyond the barrier. In the latter case, the curious birds either jumped down from the perch and walked around the barrier to have a look or leapt on top of it and peered over. There was never anything there, but they were determined to see for themselves.

A suggestive result, but not, perhaps, a conclusive one. However, the second study, carried out by Dr Bugnyar when he was working at the University of Austria, and published last month in *Animal Cognition*, suggests that ravens may have mastered the art of deception too.

In this case, the observation was serendipitous. Dr Bugnyar was conducting an experiment designed to see what ravens learn from each other while foraging. While doing so he noticed strange interactions between two males, Hugin, a subordinate bird, and Munin, a dominant one.

The task was to work out which colour-coded film containers held some bits of cheese, then prise the containers open and eat the contents. The subordinate male was far better at this task than the dominant. However, he never managed to gulp down more than a few pieces of the reward before the dominant raven, Munin, was hustling him on his way. Clearly (and not unexpectedly) ravens are able to

learn about food sources from one another. They are also able to bully each other to gain access to that food.

But then something unexpected happened. Hugin, the subordinate, tried a new strategy. As soon as Munin bullied him, he headed over to a set of empty containers, prised the lids off them enthusiastically, and pretended to eat. Munin followed, whereupon Hugin returned to the loaded containers and ate his fill.

At first Dr Bugnyar could not believe what he was seeing. He was anxious about sharing his observation, for fear that no one would believe him. But Hugin, he is convinced, was clearly misleading Munin.

As it happened, Munin was no dummy either. He soon grew wise to the tactic, and would not be led astray. He even stooped to trying to find the food rewards on his own! This made Hugin furious. “He got very angry”, says Dr Bugnyar, “and started throwing things around.” Perhaps ravens have something else in common with people—a hatred of being found out.

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The World Health Report

Battle ready

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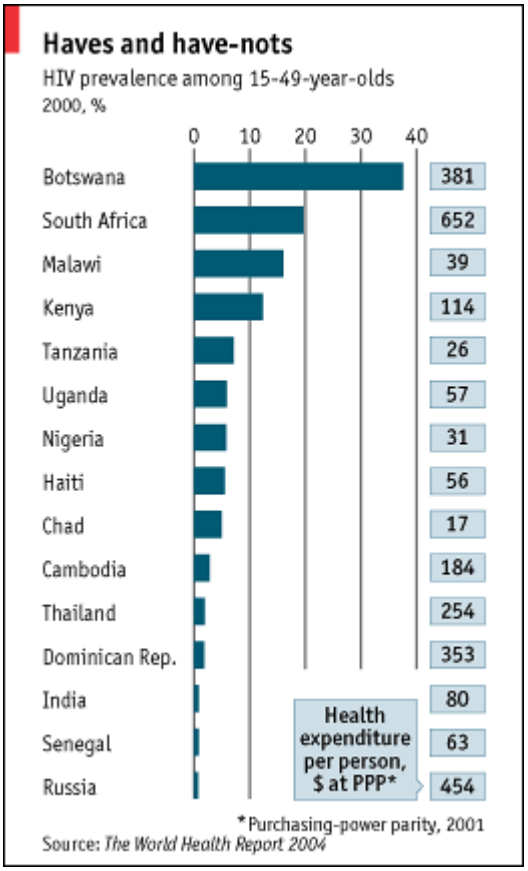
The global effort against AIDS is changing gear



THIS year's report by the World Health Organisation (WHO) on the state of humanity's health concentrates on the "3 by 5" anti-AIDS initiative that the agency, and several collaborators, announced last year. The initiative's aim is to provide anti-AIDS drugs to 3m people in poor countries by the end of 2005. That might not sound much, given that at least 34m people are now thought to be infected with HIV, the AIDS-causing virus, but it would, in fact, be a huge leap forward. At the moment, only 400,000 of these people are getting the drugs they need.

The plan is to create easy but efficient ways of delivering life-saving treatment. Obviously, pills would have to be provided in larger numbers. But drug regimens would also be simplified (at the moment, people have to take multiple pills at particular times of day). There would be better and more widely available diagnostic tests. Care and counselling would be delegated from doctors and nurses to paramedical "community health workers", to avoid wasting scarce skilled manpower. And there would, inevitably, be "mobilisation" of poor-country governments, charities, religious bodies, companies and United Nations agencies. According to Jim Kim, the head of HIV/AIDS at the WHO, the initiative will be launched in half-a-dozen countries by the summer—though which countries will benefit first has yet to be announced.

This global, concerted escalation is possible thanks to several changes that have happened over the past few years. For example, the price of anti-AIDS drugs has fallen from more than $10,000 per patient per year eight years ago, when the new generation of those drugs was introduced, to as little as $140. There is also a growing political determination, in rich and poor countries alike, that AIDS must be tackled. That is not just because it is a human tragedy, but also because it is crippling national economies and jeopardising development more broadly.

This political will has translated into more money for the fight against AIDS. Some $20 billion has already been committed by governments and charities over the next five years. (Canada has just announced it is adding $100m to the pot.) Richard Feachem, the head of the Global Fund To Fight AIDS, Tuberculosis and Malaria, another of the international bodies involved in combating the infection, reckons that "3 by 5" on its own will cost $2 billion-3 billion a year.

For all its laudable aims, however, "3 by 5" has critics. Some complain that the time-scale is unrealistic, and that even with the proposed redeployment of resources there is simply not enough suitable manpower in many poor countries to provide the necessary services. Others worry that the WHO lacks the necessary combination of entrepreneurship and organisation to pull off this bold venture, or that the initiative's emphasis on treatment will detract from the equally crucial job of prevention.

But Dr Kim is optimistic. He reckons the initiative will boost prevention, rather than undermining it, by encouraging people to seek testing and advice. That is because the system will have something more than sympathy for those who turn out to be infected. As for entrepreneurship and organisation, both

within the WHO and on the ground in poor countries, he believes that the deadline of 2005 is speeding up recruitment and the introduction of new ways of doing business.

That deadline, though, does not mark the end of the problem. AIDS drugs are a treatment, not a cure, so a patient needs to carry on taking them indefinitely. “3 by 5” is merely the beginning of a long and expensive road.

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Design

Crash-test dummies

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Building a better motorcycle crash helmet

THE enemy of the best is the good enough. That is the lesson which Kenneth Phillips, a British inventor, is learning the hard way. Dr Phillips has designed a motorcycle crash helmet that mimics the protective properties of the human head. Tests suggest that it provides 60% more protection than conventional crash helmets. If used widely, it could save many thousands of lives. So far, though, not a single company has shown an interest in developing it as a product.

When a head hits the ground during a crash, it is subjected to two kinds of acceleration: linear and rotational. Traditional helmets are good at protecting against linear acceleration, but offer limited protection against rotational forces. Rotation, however, can be particularly damaging. When the brain rotates inside the skull, blood vessels and delicate membranes get torn.

Dr Phillips, who trained as a physician and saw at first hand the damage that motorcycle accidents can cause to the head, turned to the head itself for inspiration for an improved helmet. The scalp, he observed, provides the brain with protection against rotational forces because it is elastic, compressible and moves around the skull without friction. So when a head hits a surface, the scalp absorbs some of the rotational part of the impact by moving across the skull. As a result, less energy is transferred to the delicate tissues of the brain.

To mimic this process, the Phillips helmet has an outer shell of polyethylene that moves independently of the inner cushion. It really is that simple. The resulting helmet looks and feels pretty much like a normal crash helmet. But slow-motion video footage taken during crash tests at Britain's Transport Research Laboratory, in Berkshire, shows that the outer shell does indeed move freely around the inner one, and the head is kept steady.

Dr Phillips claims that his helmet should not be much more expensive to produce than a traditional motorcycle helmet—and it would certainly be more cost-effective. He has not, however, been able to interest any existing crash-helmet manufacturers in making it. Instead, he has started his own company, Phillips Helmets (www.phillipshelmets.co.uk), with a view to manufacturing the new helmets himself.

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About sponsorship

The wild west

'Cross the wide Missouri

May 13th 2004
From The Economist print edition

Corbis

The costs and benefits of turning wilderness into wealth

THE here-today-gone-tomorrow impermanence of life in the old American west pervades David Bain's history of the penetration of the country's last frontier. Everything there has changed in the 200 years since Captain Meriwether Lewis and Lieutenant William Clark left St Louis on 14th May 1804 to explore an overland route to the Pacific. The 15m buffalo that roamed the range are gone. So are the squaws and the braves. Too many Indian peoples, once proud and free, now eke out lives of wretched humiliation on reservations. But melancholy over these sad departures is balanced by admiration for the deeds of the pioneers. They endured unimaginable hardships in turning a wilderness into one of the most prosperous places on earth.

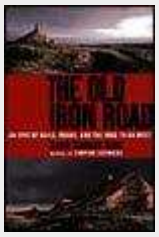
In writing this book, Mr Bain aimed to link the present to the past. His two children and his wife Mary, who has since died prematurely of heart disease, accompanied him on a 7,000-mile adventure from Omaha, Nebraska, to San Francisco's Golden Gate. In it they sought to follow, as far as possible, the tracks of the covered wagons and the rails of the first transcontinental railway.

A few odd facts are unearthed along the way: the revelation, for instance, that Malcolm X, Marlon Brando and Fred Astaire were all born in Omaha. But the Bain family is most fascinated by the boomtowns that busted when a railway by-passed them or an interstate highway left them stranded: ghostly places like Piedmont, Wyoming (above), which once bragged four saloons, a livery stable, hotels, a schoolhouse and water towers, but is now just a smear in a big landscape.

Towns serving mines grew bigger and fell even harder. Goldfield, Nevada, which had 20,000 inhabitants early in the 20th century, has a mere 450 today. Railways decayed too. In its glory days a station in Omaha serviced more than 200 passenger trains a week. Today people travel by air or by road. The old railway station is now a museum, and gift shops stand in place of the old ticket offices.

This type of destruction continues apace when, for instance, a new Wal-Mart sucks shoppers away from

The Old Iron Road: An Epic of Rails, Roads, and the Urge to Go West
By David Haward Bain



Viking; 434 pages; $27.95

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the Main Streets of nearby towns. But Mr Bain does not labour that point. His imagination is caught more by wild mid-19th century places: towns whose dedication to debauchery made them whirlpools of sin. It is the deeds of their whores, gangsters and drunks that excite him, not those of their lawmen and preachers. He lingers nostalgically in Boot Hill cemeteries, the last abodes of bodies that were shot, lynched or otherwise violently assaulted.

The reputations of a few American legends are damaged by asides. Philip Sheridan, a Unionist hero in the civil war, is exposed as a bloody ethnic cleanser. So is John Frémont, the so-called Pathfinder. He permitted a massacre of the Indians in the northern Sacramento Valley that was similar to the atrocities at Wounded Knee, Sand Creek and Bear River. “The number I killed I cannot say,” his scout, Kit Carson, recalled. “It was a perfect butchery.”

Indians friendly to the settlers were treated almost as savagely as unfriendly ones. The lament of a “co-operative” chief of the Shoshone, an Indian tribe eventually forced by the American government to share a reservation with its ancient enemies, is haunting. “The white man, who possesses this whole vast country from sea to sea, who roams over it at pleasure and lives where he likes, cannot know the cramp we feel in this little spot, with the underlying remembrance of the fact, which you know as well as we, that every foot of what you proudly call America not very long ago belonged to the red man.”

Indian killers apart, most of Mr Bain's trailblazers are likeable, even when roguish. He quotes extensively from the early writings of Mark Twain (then called Samuel Clemens), an intrepid and often sensationalist newspaper reporter on the American frontier. “To find a petrified man,” Twain later confessed, “or break a stranger's leg, or cave an imaginary mine, or discover some dead Indians in a Gold Hill tunnel, or massacre a family at Dutch Nick's, were feats and calamities we never hesitated about devising when the public needed matters of thrilling interest for breakfast.”

None of this history's characters are more genuinely heroic than the persecuted Latter-Day Saints led by Brigham Young into the desolate lands of Utah, where they made deserts prosper. Young was a man ahead of his time when it came to nature. He instructed his flock that no game was to be killed until it was wanted for food, “for it is a sin to waste life and flesh.” Few non-Mormons heeded his words. The old wild west, so utterly changed, is the poorer for it.

The Old Iron Road: An Epic of Rails, Roads, and the Urge to Go West.
By David Haward Bain.
Viking; 434 pages; $27.95

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About sponsorship

Art and mathematics

Da Vinci, codes and all that

May 13th 2004
From The Economist print edition

Pain and Abel

IN SPITE of its wooden dialogue, sketchily drawn characters and a plot that fails to fulfil its considerable promise, “The Da Vinci Code” has been a sensational bestseller. Dan Brown's mix of murder and maths, Leonardo and the Holy Grail is “occult lite”; it lacks the feeling for maths and medieval mystery conveyed in “Foucault's Pendulum”, Umberto Eco's fictional trail through the occult, published 16 years ago. Yet “The Da Vinci Code” is well on the way to achieving cult status.

For one thing, it is beginning to spawn non-fictional supporting material. Simon Cox's “Cracking the Da Vinci Code” purports to be the “guide to the facts behind the fiction”. Arranged as an alphabetical aid to people, places and groups mentioned in Mr Brown's novel, it repeats things said in the novel with scarcely any additional illumination, and without the benefit of Mr Brown's plot which is, at least until the end, fairly taut.

In “Math and the Mona Lisa”, Bulent Atalay attempts to address the actual art and science that gave Da Vinci his enduring fame. Two chapters two-thirds of the way through the book actually discuss Da Vinci, but the rest merely mention him tangentially while wandering on a disconnected journey through the totality of western art and science. At one point Mr Atalay, a professor of physics in Virginia, baldly asserts that Aristotle is the “most influential of all philosophers”. Perhaps this is true, but it needs some justification.

The book makes much of the “golden ratio”, or *phi*, a number which does indeed recur in art and nature. *Phi* has the unique property that subtracting the number one from it yields its inverse—rectangles whose sides are in the ratio of *phi* are said to be particularly pleasing. It is also the ratio that is approached as successive terms of the Fibonacci sequence—1, 1, 2, 3, 5, 8...—are divided by one another. (Terms in the sequence are the sum of the two preceding terms, so the next term here is 13.) Fibonacci, whose real name was Leonardo of Pisa, was among the first to introduce Arabic numerals to Europe, in 1202.

No doubt, the nature of *phi* is an interesting subject, and it features in Mr Brown's twisty plot. But “Math and the Mona Lisa” is not the first book to list recurrences of *phi* in various places. Mr Atalay, it seems, once visited the pyramids as a young boy and found *phi* there. (He conveniently provides supporting evidence in the shape of a picture of himself at Giza.)

Another recent book discusses the achievements of both Leonardos far more captivatingly as it builds up to the story of a remarkable proof made in 1824 by Niels Abel, a 21-year-old Norwegian mathematician, who died in poverty a scant five years later. Abel proved that equations of the fifth order cannot generally be solved. If the exact meaning of this sentence baffles you, read “Abel's Proof”. It gives a clear exposition of the underlying mathematics and eloquently discusses the lives of mathematicians up to Abel's time.

Indeed, Peter Pesic's tale of how maths came to be is as exciting as any fiction. In contrast to Mr Atalay, who uses Da Vinci merely as a peg from which to hang

Cracking the Da Vinci Code: The Facts Behind the Fiction
By Simon Cox

Michael O'Mara Books; 160 pages; £6.99. To be published in the United States by Sterling in August

Buy it at
Amazon.co.uk

Math and the Mona Lisa: The Art and Science of Leonardo da Vinci
By Bulent Atalay

Smithsonian Books; 314 pages; $24.95

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Abel's Proof: An Essay on the Sources and Meaning of Mathematical Unsolvability
By Peter Pesic

his own rumpled cloak of a book, Mr Pesic uses Abel's proof as a focal point, which he approaches and moves away from with a measured, mathematical pace. He concludes with a cryptic page from one of Abel's notebooks which, riddled with drawings, writings and numbers, is reminiscent of Da Vinci's own scribblings. In the midst of the equations is scrawled a prayer: “Our Father who art in Heaven, give me bread and beer. Listen for once.” The Norwegian mathematician and the Italian artist, though separated by centuries, might have got on rather well.

MIT Press; 213 pages; $14.95

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Cracking the Da Vinci Code: The Facts Behind the Fiction.
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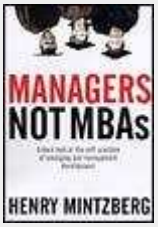
Management education

No More Boring Analysis?

May 13th 2004
From The Economist print edition

HOW do you teach managers to manage? Henry Mintzberg, a professor of management at McGill University in Montreal, has long held a contrary view to that proposed by most business schools. In this constantly stimulating book he divides his answer into two parts: first, he argues that the traditional qualification, the Masters of Business Administration (MBA), is the wrong way—he says it "prepares people to manage nothing". Then he expounds what he believes is the right way: an imprecise mix of personal reflection and the sharing of experience.

Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development
By Henry Mintzberg



Berrett-Koehler; 480 pages; $27.95

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Mr Mintzberg finds fault with the emphasis that many MBA programmes place on frenetic case studies which encourage students to come up with rapid answers based on meagre data. But more than that, he criticises them for their concentration on dry analysis. Such courses, he says, enable their graduates to "speak convincingly in a group of 40 to 90 people", and make them believe they can leapfrog over experience. That, though, is not the sum total of what is required to manage a complex commercial organisation.

Synthesis, not analysis, argues Mr Mintzberg, "is the very essence of management". On several occasions he cites Robert McNamara, once president of the Ford Motor Company and a United States secretary of defence in the 1960s, as the archetypal MBA, a man who thought that even in Vietnam "generic analysis could substitute for situational knowledge". More recently, the qualification has been thrown into deeper disrepute by the heavy dependence of companies such as Enron on MBA recruits. Its former chief executive Jeffrey Skilling, currently awaiting trial on 36 charges of fraud and insider trading, liked to boast that he came in the top 5% of his MBA class at the Harvard Business School.

And yet, if the MBA is so bad at teaching management, how come America has far more successful businesses than Europe and Japan, areas of the world that are significantly less enthusiastic about such methods of learning? Leaving aside the unprovable rejoinder that American firms would have done even better without the MBA, Mr Mintzberg argues that any list of America's most admired corporate leaders is heavily loaded with people who don't have the qualification: Bill Gates, Warren Buffett, Jack Welch, Michael Dell and Andy Grove, to name but a few. The fact that some 40% of the bosses of America's biggest companies today have an MBA is, he claims, largely due to the fact that the system is self-perpetuating. "Enabling Harvard to place so many people at the top is the fact that Harvard already has so many people at the top."

Mr Mintzberg is not alone these days in questioning the value of the traditional MBA. Leading consultants such as McKinsey and Mercer are spreading their recruitment net much more widely. Mercer's London office says that one year's in-house training enables young graduates to "run circles round newly minted MBAs". In its February issue, the *Harvard Business Review* (no less) said that "an arts degree is now perhaps the hottest credential in the world of business", with corporate recruiters trawling places such as the Rhode Island School of Design.

"Managers not MBAs" throws a stone into the often complacent world of management education. It should be required reading for anyone who has the qualification, wants one, or just wonders what all the fuss is about.

Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development. By Henry Mintzberg.

Berrett-Koehler; 480 pages; $27.95

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Exploration in South America

Enduring love

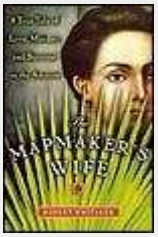
May 13th 2004
From The Economist print edition

THE French expedition that left for South America in 1735, led by Voltaire's friend Charles-Marie de la Condamine, was supposed to resolve the old debate over whether the earth was shaped like an onion or like a fat man wearing a tightly-cinched belt. In the end, the onion triumphed. But the expedition also produced the earliest complete maps of the northern part of the continent, and it introduced to Europe a grey-white metal that the South Americans called platinum and a liquid latex that could be moulded and shaped and was useful in protecting against rain and humidity. The natives called it *caoutchouc*; we call it rubber.

This extended French ramble through the Amazon is a well-known story and Robert Whitaker retells it well enough. But what really brings his book alive is his detailed account of what happened when Jean Godin, the expedition's geographer, and his Peruvian wife, Isabel, became separated by the political fall-out from the Seven Years' War.

Settled in Peru, yet determined to return to France, Godin set out in 1749 to try and leave the continent by an eastern route, which would take him down the Bobonaza and Pastaza rivers, tributaries of the upper Amazon. Having first established that the voyage was feasible, Godin's plan was to return to collect his wife and the child she was carrying.

The Mapmaker's Wife: A True Tale of Love, Murder, and Survival in the Amazon
By Robert Whitaker



Basic Books; 288 pages; $25. To be published in Britain by Doubleday in August

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He made it as far as French Guiana, where, broke and friendless, he became stranded for more than 20 years. Isabel Godin, meanwhile, raised her daughter alone. Only after the child's death of smallpox at the age of 19 did she set off down-river in search of the geographer, dressed in a velvet petticoat and carried in a palanquin, accompanied by two of her brothers and a nephew. Along the way, their guides absconded, Isabel's canoe capsized, her nephew drowned and the brothers died of starvation. The newspapers pronounced her dead.

Yet in February 1770, four months after leaving her home in Peru, Isabel Godin emerged from the jungle, dressed only in a shawl and a pair of men's trousers. Her feet were lacerated and bleeding, her face infested with botfly maggots. She had been kept alive, she insisted, by the vision of her husband urging her onward. Jean, meanwhile, wrote to de la Condamine: “I again met with a cherished wife, whom I had almost given over every hope of seeing again.” Husband and wife returned to France, where they died, one soon after the other, in 1792, at the start of the Terror that followed the French revolution.

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Rubens

A man of many tints

May 13th 2004
From The Economist print edition

Reassessing a great European artist

IN THE popular imagination, Rubens (1577-1640) is a painter of well-fed ladies with rich flesh tones. But this year a series of exhibitions in his home town of Antwerp, in the nearby city of Lille and elsewhere across Europe seek to show him as a more well-rounded artist (as it were), a man who also painted an equal number of sober political and religious subjects with a wealth of inventive detail. The Lille exhibition, which runs at the newly restored Palais des Beaux-Arts until June 14th, is already breaking records, a testament to the artist's enduring popularity.

The confidante of kings and queens, a diplomat, scholar and art collector who travelled widely across Europe, Rubens was a genuinely European genius. Even his name—Pietro Paul—mixed two different languages, and the artist himself spoke six. The child of Protestants exiled from Antwerp, he was born in Germany. But when his father died, his mother moved back to her family in Antwerp and reverted to Catholicism. A product of both religious cultures, with first-hand experience of their bloody wars, Rubens was well equipped when called upon (in 1628) to broker a peace between Catholic Spain and Protestant England.

In his art Rubens was a pan-European too. He trained first with the Flemish masters in Antwerp, copying Holbein's woodcuts, before crossing the Alps to travel through Italy for eight years. He lived in Genoa for a spell, which is why that city (like Lille, a “European Capital of Culture” this year) is claiming him as an adopted son in a show of his work that continues until July 11th. As court painter to the Gonzagas dynasty in Mantua, Rubens absorbed all the art and antiquities that he could feast his eyes upon in their world-famous collections.

In Rome he copied the Vatican's classical sculptures, as well as Caravaggio's altarpieces; in Venice he admired the works of Titian and Veronese. He would have stayed in Italy indefinitely had his mother not called him home from her deathbed. When he arrived in Antwerp, he was received as a returning hero. The Archduchess Isabella begged him to become her court painter and gave him a castle and a title. Alongside his Flemish burgher's house he built an Italian palazzo for his studio and his art collection.

And it is here, in Rubens's own house, that the centrepiece of the Rubens Year is to be seen: a reconstruction of the artist's own art collection. The exhibition (showing until June 13th) mixes well-known masterpieces with works by artists beloved by Rubens but almost unknown today. It is a once-in-a-lifetime opportunity to see what the great artist learned from, and what he cherished.

It is particularly revealing to see his copies of Titian alongside their originals. Whereas the Venetian master portrayed the brutality of the myth of Diana and Callisto, Rubens invested the scene with compassion. And it is this human touch that made him famous. One of his earliest masterpieces, the life-size “Deposition of Christ” in Antwerp Cathedral, portrays the dead Jesus with a contorted, bloodless body modelled on a famous sculpture of Hercules in Rome. But the descent of the heroic figure into the arms of his bearers could move a stone, and it has inspired generations of artists with its message of eternal love and compassion.

To see such works in their original setting is a special treat. But there is more. Most of the paintings in his Antwerp house were made either early in Rubens's career, when he was building his reputation, or for his family and friends. So they are all done by Rubens himself, rather than by his army of studio assistants. An astute businessman, Rubens had a complex pricing structure which was based on how much of a painting he did himself. Cheaper works were executed by the assistants who helped him in his studio.

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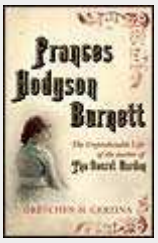
Frances Hodgson Burnett

Creating happy endings

May 13th 2004
From The Economist print edition

THE author of “Little Lord Fauntleroy” was the J.K. Rowling of her time. Frances Hodgson Burnett (1849-1924), like the creator of Harry Potter, lived a rags-to-riches success story as the bestselling author of her day. She made a fortune by writing a children's novel that appealed to grown-ups and became a hit as a serial, a book and a play. It inspired an entire generation of boys to rebel against being forced by their mothers to wear “girlish” velvet Fauntleroy outfits.

Frances Hodgson Burnett: The Unexpected Life of the Author of The Secret Garden
By Gretchen Holbrook Gerzina



Rutgers University Press; 400 pages; $29.95
Chatto & Windus; £20

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This new biography will come as an eye-opener to anyone who has ever read “Fauntleroy”, “The Secret Garden” or “A Little Princess”, and lapped up the details of dress, settings and character that Burnett layered on her stories like cream on a rich English pudding. For a start, Frances had a childhood that reads straight out of one of her tales of reversal of fortune. One of five children born into a well-off Manchester family, she lost her father when she was three. Her mother struggled to run the family business alone, losing money as the American civil war hit the Manchester economy. Eventually she accepted the invitation of her adventurer brother in Tennessee and moved to America. But the brother turned out to be a gambler; the Knoxville house he promised them was a cabin in a one-horse town.

Through it all Frances read everything she could lay her hands on—Trollope, Dickens, Thackeray, encyclopedias and ladies' magazines—and told stories to amuse her young siblings, writing them down in the margins of used household account books. As the family sank into poverty in East Tennessee, she sold grapes to pay for the paper and stamps to send off her first story for publication.

Gretchen Gerzina argues plausibly that much of what Frances experienced in her youth—poverty; class distinction; emigration; smoky city versus idyllic countryside; America versus England; and, most of all, people who dream of a brighter future—became constant themes of her novels. But Ms Gerzina also reveals the dark side of one of the sunniest storytellers of all time.

Hodgson married the boy next door (Mr Burnett), but more out of duty than love. She worked non-stop to support his fledgling medical practice while bearing him two sons, and suffered bouts of depression that continued throughout her life. She later divorced him, moved back to England and married a younger “soul mate”, whom she also later divorced before retiring with her sister to Long Island.

In order to churn out her continuous stream of money-making fiction, she was a largely absent mother. One of her sons became heartsick over being parted from his “dearest” (a name for mother that Frances coined in Fauntleroy) and ultimately died of consumption in her arms. The other never recovered from being the model for Fauntleroy and died young after saving others in a heroic fashion worthy of the little lord himself.

Any fan of Hodgson's work will be frustrated that relatively little space in this hefty tome is devoted to her creative process and her well-loved books, while pages are given over to the mundane details of her life. But read as the story of an independent working mother struggling to make her fortune in a world that had not seen her kind before, it can be gripping stuff indeed. Hodgson was a 19th-century novelist living a decidedly modern life, but with no role models to follow. Like a heroine in one of her own novels, she did not dwell on this: instead she made a career out of writing the happy endings that she sought, but so rarely found, in reality.

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Obituary

The Duke of Devonshire

May 13th 2004
From The Economist print edition

PA

Andrew Cavendish, 11th Duke of Devonshire, died on May 3rd, aged 84

THE village of Edensor in Derbyshire is a pretty place. Its houses are eccentric, with Tudor chimneys and Italian doorways, and they sit around a spacious green planted with laburnum trees. The church boasts both a tower and spire, and it is here that Andrew Cavendish now lies along with many of his forebears. Edensor was moved and rebuilt by the sixth duke in the 19th century because, sitting as it used to on a ridge east of Chatsworth, it spoiled the view. It now blends seamlessly into the wide sweep of parkland that leads down to the great house, and knows its place: a tiny settlement amid 35,000 acres of moorland, woodland, meadows and gardens, all owned by one family.

The 11th duke could never quite believe he possessed all this. Delightedly, he would count his Chatsworth assets: 297 rooms, 112 fireplaces, 56 loos, 2,084 lightbulbs. The beauty of the house, stacked with books, paintings and sculpture collected by the Cavendishes for 450 years, constantly enthralled him. Chatsworth, he once remarked, was his idea of heaven; that, and drinking tea in the hall at Brooks's Club in St James's.

Nor was this all. He owned another 40,000 acres, including Bolton Abbey, the most romantic ruin in Yorkshire; Lismore Castle in Ireland; a chunk of the West End and a goodly extent of Eastbourne, a shabbily genteel resort on the Sussex coast. Each year the duke would spend a week there in his own hotel, the Cavendish, relishing the end-of-the-pier shows and the distant blare of military bands.

If he never took any of this for granted, strolling through life with an air of the utmost diffidence and happiness, it was because he had never expected it. As the second son of the 10th duke, he was told he would inherit nothing. He was vaguely preparing himself for a career in publishing when his elder brother was killed in action, in 1944, and everything was his.

Having stumbled by sheer luck into the Cavendish inheritance, he then almost lost it again. His father's sudden death in 1950 saddled him with almost £7m in death duties, or 80% of the estate. Drastic measures were necessary. Hardwick Hall, another ravishing Elizabethan house in Derbyshire, was sold to the National Trust. Several Rembrandts, Van Dycks and Raphaels went to galleries, and the Caxton and Shakespeare first folios to America. The duke himself was driven to working as a minister of state in the government of his uncle, Harold Macmillan: a reward, he supposed, for having given him some good shooting. Around 150 staff had to be dismissed, including 15 gardeners. It was touch and go whether the magnificent cascades could be kept flowing and the topiary trimmed.

At this desperate point the duke took a leaf from the book of his hero and exemplar, the sixth duke. William Spencer Cavendish had been a member of the Whig party in the early 19th century: a liberal reformer and anti-slavery campaigner who, though a grandee to his fingertips, empathised with the common man. He eventually opened Chatsworth to the public every day, especially making sure that the great fountain was working for them to see. Whatever new wings he built, or new sculptures he acquired in Italy, he believed should be shared with the gawping crowd.

Noblesse oblige

The 11th duke, pushed on by his “bossy” Mitford duchess, decided to do the same. Chatsworth was made over to an independent charitable trust, with the family renting their quarters, and the doors were flung open to visitors. Every possible means of making money was employed, as long as it was consonant with dignity; the duke had no wish to make his house a “circus”, like Woburn or Beaulieu. A shop was opened, the first of its kind, selling branded cushions, teapots and hand cream; a farm shop offered Stilton and game. A hotel was built, then a conference centre. The duke happily attached his name to a hamper, retailing at £499, containing sloe gin, sausages and chutney. By 2002, Chatsworth was making a profit and bringing in 500,000 visitors a year.

The taxman, you could argue, had forced him to this pass. But the duke was also devoted to a far more ancient concept, *noblesse oblige*. Having been so fortunate, and having done nothing, as he said, to deserve it, it was incumbent on him to be generous to others. He opened his vast “back garden” to ramblers, where his grandfather had used his gamekeepers to send them packing. In 1991 he founded the Polite Society after an aged taxi-driver, pressing his hand, told him how good it felt to be thanked. He was active in all kinds of charities, and helped to save the Chesterfield football team from extinction.

Those with no stomach for feudalism remained unimpressed. They muttered about his fortune (£1.6 billion, by some estimates), his gaming and horse-racing, his pretty young mistresses, his self-declared “dimness”, and all the usual failings of the English upper classes. They were scandalised by his pledge to break the law if fox-hunting was banned, and by his patronage of the Europhobic UK Independence Party. But his Chatsworth staff, more than 600 of them, all of whom felt he had known and respected them, put on their uniforms and lined the road that led through the deer park to Edensor.

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Overview

May 13th 2004
From The Economist print edition

America's economic recovery became less “jobless”. In April non-farm payrolls grew by a higher-than-expected 288,000. In addition, the figures for earlier months were revised upward. New non-farm jobs in March, originally estimated at 308,000, were revised to 337,000. The figure for February grew by 83,000, nearly twice the original estimate. The unemployment rate fell from 5.7% in March to 5.6% in April.

America's buoyant job figures caused turmoil in **financial markets**. Bond yields rose and stockmarkets tumbled across the world amid fears that America's Federal Reserve will raise interest rates as early as June.

America's trade deficit continued to grow in March to $46 billion, another all-time high. During the month, the value of imports grew by 4.6%, while the value of exports rose by only 2.6%.

The **euro area** is sending mixed economic signals. **German** production stuttered: industrial output fell unexpectedly by 2.3% in March. For the year to March, industrial output fell by 0.7%. The **Netherlands**, too, suffered a setback. Industrial production fell by 1.0% in the year to March, following an equal decline in the year to February. There was happier news elsewhere in the euro area. Industrial production in the year to March rose by 8.0% in **Spain**, and by 1.5% in **France**.

Consumer prices in **Sweden** rose by 0.3% in the year to April, down from 2.3% growth in the previous year. In **Denmark**, consumer-price inflation ran at 0.8% in the year to April.

An economic recovery may be taking hold in **Switzerland**. Unemployment fell to 3.9% in April, down from 4.1% in March.

Unemployment also fell in **Canada,** from 7.5% in March to 7.3% in April. Payrolls grew by 49,600, around three times the expected number.

Britain's manufacturing output suffered a surprise fall in March. That contributed to a 12-month decline in industrial output of 0.6%. Producer prices rose by 0.3% in April, and by 1.8% in the year to April. Nominal earnings rose by 5.2% in the year to March. Also in March, Britain ran a trade deficit of £4.1 billion, unchanged from February.

Oil prices rose to almost $41 a barrel for the first time in more than 13 years.

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Output, demand and jobs

May 13th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.9	+ 3.1	– 0.1	Q3	+ 7.7	Q1	5.6	Apr	6.2
Austria	+ 0.8	Q4	+ 0.4	+ 1.6	+ 2.0	+ 3.1	Jan	– 1.0	Feb	4.5	Apr	4.3
Belgium	+ 1.9	Q1	+ 2.4	+ 1.9	+ 1.9	+ 5.4	Mar	– 0.9	Feb	12.4	Apr†	11.6
Britain	+ 3.0	Q1	+ 2.6	+ 3.2	+ 2.7	– 0.6	Mar	+ 6.4	Mar	4.7	Feb††	5.1
Canada	+ 1.6	Q4	+ 3.8	+ 2.7	+ 3.3	+ 0.8	Feb	+ 1.1	Jan	7.3	Apr	7.6
Denmark	+ 1.0	Q4	+ 2.4	+ 1.9	+ 2.2	– 1.0	Feb	+ 5.3	Feb	6.4	Mar	5.8
France	+ 1.2	Q4	+ 2.7	+ 1.8	+ 2.1	+ 1.5	Mar	+ 2.9	Mar	9.8	Mar	9.6
Germany	+ 1.5	Q1	+ 1.8	+ 1.4	+ 1.6	– 0.7	Mar	– 0.7	Mar	10.5	Apr§	10.7
Italy	+ 0.1	Q4	nil	+ 1.0	+ 1.7	+ 0.2	Feb	– 2.1	Feb	8.5	Jan	8.9
Japan	+ 3.4	Q4	+ 6.4	+ 3.3	+ 2.0	+ 7.7	Mar	+ 0.9	Feb	4.7	Mar	5.4
Netherlands	– 0.4	Q4	+ 1.7	+ 0.8	+ 1.6	– 1.0	Mar	– 4.6	Feb‡	6.4	Mar**	4.7
Spain	+ 2.8	Q1	+ 2.4	+ 2.8	+ 2.9	+ 8.0	Mar	+ 4.5	Mar	11.1	Mar	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.4	+ 2.4	+ 2.2	Mar	+ 5.3	Mar	5.8	Mar†	4.6
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.8	+ 1.7	Q4	+ 3.7	Feb	3.9	Apr†	3.6
United States	+ 4.9	Q1	+ 4.2	+ 4.7	+ 3.6	+ 3.4	Mar	+ 9.2	Mar	5.6	Apr	6.0
Euro area	+ 0.6	Q4	+ 1.2	+ 1.6	+ 2.0	+ 0.6	Feb	+ 0.9	Mar	8.8	Mar	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	nil	Mar	+ 3.6	Feb	9.5	Mar†	9.9
Greece	+ 5.0	Q4	na	na	na	+ 3.8	Mar	+ 6.4	Feb	na		na
Iceland	+ 4.9	Q4	na	na	na	– 0.3	2002	na		3.6	Feb†	4.1
Ireland	+ 2.7	Q4	na	na	na	+ 3.4	Feb	+ 2.6	Feb	4.4	Apr	4.4
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 3.9	Dec	4.4	Feb	3.8
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 6.0	Q4	4.3	Q1	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 0.2	Feb	+ 7.6	Mar	4.2	Q4	3.7
Portugal	– 0.5	Q4	– 1.0	na	na	– 4.5	Feb	+ 2.7	Mar	6.6	Q4†	6.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 2.9% in Apr. §EU harmonised rate 9.3% in Mar. **Jan-Mar.

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Prices and wages

May 13th 2004
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2004	The Economist poll consumer prices forecast 2005	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.2	+ 2.5	– 1.1	Q1	+ 3.0	+ 5.9	Q4	+ 3.9
Austria	+ 1.6	Mar	+ 1.8	+ 1.3	+ 1.4	+ 5.2	Apr	+ 0.8	+ 2.1	Mar	+ 2.2
Belgium	+ 1.9	Apr	+ 1.5	+ 1.4	+ 1.5	+ 2.2	Mar	+ 0.8	+ 1.9	Q1	+ 2.4
Britain	+ 1.1	Mar*	+ 1.6	+ 1.5	+ 1.8	+ 1.8	Apr	+ 1.6	+ 5.2	Mar†	+ 3.3
Canada	+ 0.7	Mar	+ 4.3	+ 1.6	+ 2.0	– 2.5	Feb	+ 2.8	+ 3.1	Feb	+ 2.2
Denmark	+ 0.8	Apr	+ 2.5	+ 1.4	+ 2.0	+ 0.3	Mar	+ 0.7	+ 3.7	Q4	+ 3.9
France	+ 2.1	Apr	+ 2.0	+ 1.9	+ 1.6	+ 0.1	Mar	+ 2.1	+ 2.7	Q4	+ 3.5
Germany	+ 1.6	Apr	+ 1.0	+ 1.2	+ 1.1	+ 2.4	Apr	– 3.8	+ 1.9	Feb	+ 2.4
Italy	+ 2.3	Apr	+ 2.7	+ 2.2	+ 2.1	+ 0.6	Mar	+ 2.8	+ 2.8	Mar	+ 1.7
Japan	– 0.1	Mar	– 0.1	– 0.2	nil	+ 0.2	Mar	– 0.8	+ 2.0	Feb	+ 1.9
Netherlands	+ 1.4	Apr	+ 2.1	+ 1.3	+ 1.3	+ 0.6	Dec	+ 4.2	+ 1.8	Mar	+ 3.2
Spain	+ 2.1	Mar	+ 3.7	+ 2.3	+ 2.4	+ 0.8	Mar	+ 3.0	+ 3.3	Q4	+ 3.9
Sweden	+ 0.3	Apr	+ 2.3	+ 0.8	+ 1.6	– 1.4	Mar	+ 0.6	+ 2.7	Dec	+ 4.0
Switzerland	+ 0.5	Apr	+ 0.7	+ 0.4	+ 0.8	– 0.1	Mar	+ 0.3	+ 1.8	2002	+ 2.5
United States	+ 1.7	Mar	+ 3.0	+ 1.9	+ 1.8	+ 1.4	Mar	+ 4.0	+ 2.2	Apr	+ 3.0
Euro area	+ 1.7	Mar	+ 2.4	+ 1.7	+ 1.6	+ 0.4	Mar	+ 2.4	+ 2.5	Q4	+ 3.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.5	Mar	+ 1.6	na	na	– 0.6	Mar	+ 1.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.9	Apr	+ 3.4	na	na	+ 1.9	Mar	+ 2.0	na		na
Iceland	+ 2.2	Apr	+ 2.3	na	na	+ 2.7	Apr	+ 3.2	+ 3.3	Feb	+ 5.6
Ireland	+ 1.3	Mar	+ 4.9	na	na	– 5.1	Mar	– 7.1	+ 6.1	Q4	+ 6.4
Luxembourg	+ 1.8	Mar	+ 2.7	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.1	Q4	– 1.4	+ 2.2	Q1	+ 2.3
Norway	+ 0.4	Apr	+ 2.9	na	na	+12.2	Apr	– 4.9	+ 3.9	Q4	+ 5.2
Portugal	+ 2.3	Mar	+ 3.9	na	na	+ 0.3	Mar	+ 2.1	+ 0.8	Feb	– 0.4

*New series. RPI inflation rate in March: 2.6%. †Jan-Mar.

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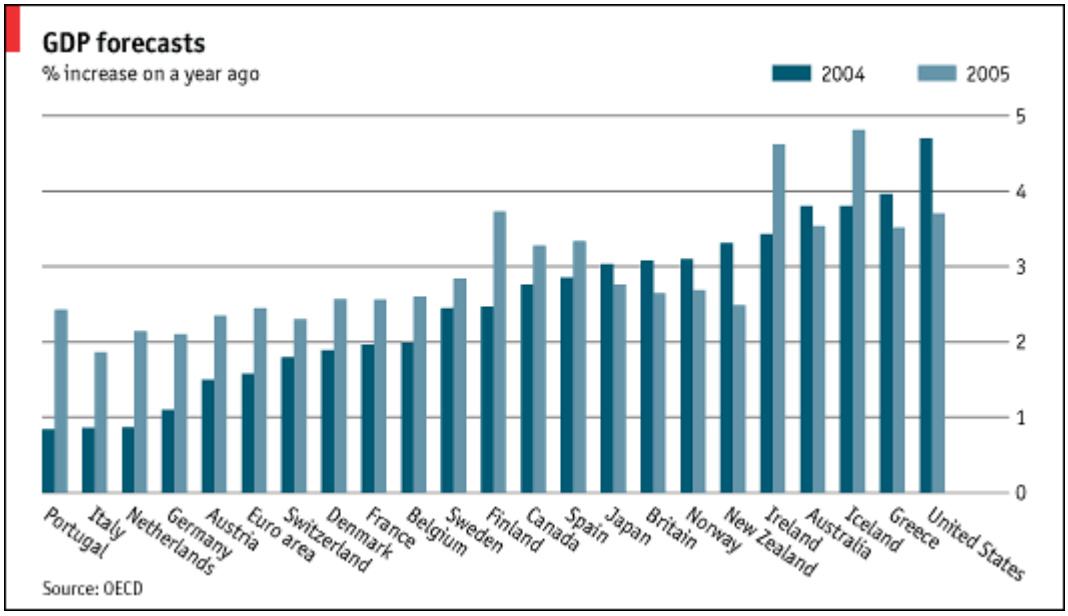
GDP forecasts

May 13th 2004
From The Economist print edition



America is tipped to have the fastest-growing economy among rich countries in 2004, according to the latest forecasts from the OECD. The Paris-based organisation expects America's GDP to rise by 4.7% this year and by 3.7% in 2005. Japan's economy is expected to grow by 3% in 2004, while the euro area is likely to see only 1.6% GDP growth. In 2005, the OECD expects a modest acceleration in euro-area GDP growth to 2.5%.

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Money and interest rates

May 13th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 12th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.0	+13.9	Mar	5.49	4.78	5.34	6.05	5.10	6.89
Britain	+ 7.1	+ 7.7	Mar	4.38	3.63	4.71	5.10	4.20	5.92
Canada	+11.6	+ 8.9	Mar	1.98	3.21	2.95	5.13	4.81	6.13
Denmark	+ 8.1	+10.6	Mar	2.25	2.70	2.60	4.46	4.10	5.55
Japan	+ 4.1	+ 1.9	Apr	0.02	0.02	0.13	1.54	0.58	1.62
Sweden	+ 0.5	+ 2.2	Mar	1.99	3.26	2.97	4.68	4.36	3.18
Switzerland	+11.6	+ 5.1	Mar	0.27	0.30	1.22	2.76	2.27	2.55
United States	+ 7.5	+ 4.5	Mar	1.07	1.21	2.58	4.79	3.52	6.17
Euro area†	+11.4	+ 6.3	Mar	2.08	2.43	2.53	4.27	3.86	4.08

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.52%, Japan No. 259 1.53%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.25%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 13th 2004
From The Economist print edition

1995=100

	May 4th	May 11th*	% change on one month	% change on one year
Dollar index				
All items	99.6	97.5	– 1.5	+26.3
Food	99.8	97.7	+ 0.5	+21.9
Industrials				
All	99.3	97.2	– 4.1	+32.9
Nfa†	98.0	98.8	+ 2.0	+33.8
Metals	100.3	95.8	– 8.9	+32.1
Sterling index				
All items	87.6	87.5	+ 1.8	+15.6
Euro index				
All items	108.4	108.6	– 0.6	+23.2
Yen index				
All items	116.4	118.0	+ 4.9	+37.5
Gold				
$ per oz	391.75	376.75	– 7.7	+ 7.4
West Texas Intermediate				
$ per barrel	38.92	40.07	+ 7.9	+40.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

May 13th 2004
From The Economist print edition

Market indices

	May 12th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,383.9	3,462.9	3,274.9	– 0.9	– 2.3	+ 2.4	– 5.3
Austria (ATX)	1,848.6	1,985.9	1,568.9	– 5.2	– 6.9	+19.6	+12.9
Belgium (Bel 20)	2,362.0	2,517.3	2,244.2	– 3.9	–35.8	+ 5.3	– 0.7
Britain (FTSE 100)	4,412.9	4,575.7	4,309.4	– 3.4	–36.3	– 1.4	– 2.3
Canada (Toronto Composite)	8,187.7	8,898.8	8,129.5	– 3.2	–28.1	– 0.4	– 7.2
Denmark (KBX)	223.0	241.3	219.0	– 3.0	–26.1	+ 4.4	– 1.5
France (SBF 250)	2,429.2	2,594.4	2,411.5	– 4.4	–44.7	+ 0.7	– 5.0
(CAC 40)	3,564.3	3,811.4	3,465.3	– 4.4	–48.5	+ 0.2	– 5.5
Germany (DAX)	3,776.2	4,151.8	3,726.1	– 6.1	–53.2	– 4.8	–10.2
Italy (BCI)	1,284.6	1,340.3	1,239.5	– 2.9	–41.1	+ 2.2	– 3.6
Japan (Nikkei 225)	11,153.6	12,163.9	10,365.4	– 5.2	–71.3	+ 4.5	– 1.1
(Topix)	1,122.3	1,217.9	1,022.6	– 5.4	–61.1	+ 7.5	+ 1.8
Netherlands (AEX)	326.0	364.8	326.0	– 5.7	–53.5	– 3.4	– 8.9
Spain (Madrid SE)	823.5	881.7	808.3	– 4.7	–28.2	+ 1.9	– 3.8
Sweden (Affarsvarlden Gen)	193.8	218.1	188.5	– 5.0	–51.6	+ 2.9	– 3.9
Switzerland (Swiss Market)	5,644.9	5,934.4	5,469.0	– 4.2	–32.9	+ 2.9	– 1.5
United States (DJIA)	10,045.2	10,737.7	9,990.0	– 2.6	–14.3	– 3.9	– 3.9
(S&P 500)	1,097.3	1,157.8	1,087.1	– 2.2	–28.2	– 1.3	– 1.3
(NASDAQ Comp)	1,925.6	2,153.8	1,896.1	– 1.6	–61.9	– 3.9	– 3.9
Europe (FTSE Eurotop 300)*	969.4	1,026.2	957.9	– 3.9	–43.1	+ 1.2	– 4.5
Euro area (FTSE Ebloc 100)*	813.6	888.3	813.6	– 4.9	–47.5	– 2.2	– 7.7
World (MSCI)†	1,012.1	1,085.8	1,001.7	– 4.0	–30.1	– 2.3	– 2.3
World bond market (Citigroup)‡	578.8	619.5	576.3	– 2.7	– 6.6	– 4.1	– 4.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 13th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 May 12th	year ago	Currency units per $ May 12th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0	Mar	− 30.0	Q4	− 5.2	− 4.5	84.5	80.8	1.43	1.55	2.55	1.71	1.27	0.5
Austria	− 0.7	Feb	− 1.9	Feb	− 0.3	− 0.6	103.1§	102.0	0.84	0.87	1.49	–	0.74	-1.3
Belgium	+ 20.8	Feb	+ 8.0	Dec	+ 3.7	+ 3.8	103.2§	102.0	0.84	0.87	1.49	–	0.74	-0.2
Britain	− 83.3	Mar	− 30.8	Q4	− 2.5	− 2.5	104.7	98.1	0.56	0.62	–	0.67	0.50	-2.9
Canada	+ 45.2	Mar	+ 18.5	Q4	+ 1.7	+ 1.1	83.6	84.6	1.39	1.38	2.46	1.65	1.23	1.2
Denmark	+ 9.3	Feb	+ 6.3	Feb	+ 2.5	+ 2.4	106.1	106.5	6.25	6.46	11.1	7.44	5.53	0.9
France	+ 4.9	Mar	+ 11.4	Feb	+ 1.0	+ 0.9	106.8§	105.2	0.84	0.87	1.49	–	0.74	-3.8
Germany	+166.7	Mar	+ 63.3	Mar	+ 2.4	+ 2.4	104.5§	102.5	0.84	0.87	1.49	–	0.74	-3.7
Italy	+ 0.7	Feb	− 19.0	Feb	− 0.9	− 1.0	76.2§	75.0	0.84	0.87	1.49	–	0.74	-3.1
Japan	+113.8	Feb	+149.9	Feb	+ 3.2	+ 3.2	131.7	130.7	113	116	201	135	–	-7.1
Netherlands	+ 32.0	Feb	+ 14.4	Q4	+ 2.3	+ 2.5	102.7§	101.4	0.84	0.87	1.49	–	0.74	-3.1
Spain	− 54.8	Feb	− 23.8	Jan	− 2.9	− 2.9	77.2§	76.4	0.84	0.87	1.49	–	0.74	0.3
Sweden	+ 20.7	Mar	+ 18.9	Q4	+ 5.6	+ 5.4	80.7	80.5	7.70	7.98	13.7	9.16	6.80	0.2
Switzerland	+ 7.7	Mar	+ 32.9	Q4	+10.3	+10.1	112.5	114.6	1.29	1.31	2.29	1.54	1.14	-1.6
United States	−560.4	Mar	−540.9	Q4	− 5.1	− 5.0	100.0	102.7	–	–	1.78	1.19	0.88	-4.7
Euro area	+ 88.2	Feb	+ 37.2	Feb	+ 0.5	+ 0.4	89.9	90.2	0.84	0.87	1.49	–	0.74	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.2	Feb	+ 10.4	Feb	na	na	82.3§	81.0	0.82	0.87	1.46	–	0.72	1.6
Greece	− 26.3	Feb	− 11.2	Feb	na	na	59.7§	59.0	0.82	0.87	1.46	–	0.72	-3.2
Iceland	− 0.3	Mar	− 0.6	Q4	na	na	98.6**	97.7	73.2	73.0	130	87.1	64.7	0.2
Ireland	+ 41.0	Feb	− 3.0	Q4	na	na	94.4§	93.0	0.82	0.87	1.46	–	0.72	-0.5
Luxembourg	− 3.6	Feb	+ 2.5	Q4	na	na	103.2§	102.0	0.82	0.87	1.46	–	0.72	-1.8
New Zealand	− 2.3	Mar	− 3.5	Q4	na	na	99.7	97.2	1.57	1.74	2.79	1.87	1.39	2.9
Norway	+ 27.9	Mar	+ 29.7	Feb	na	na	98.0	102.3	6.74	6.85	12.0	8.02	5.96	10.4
Portugal	− 14.2	Feb	− 8.1	Feb	na	na	94.0**	92.5	0.82	0.87	1.46	–	0.72	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, March average. ‡OECD forecast. **IMF, February average.

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Exchange-rate forecasts

May 13th 2004
From The Economist print edition

Exchange-rate forecasts

From J.P. Morgan Chase, currency units per $

	May 12th	3-month	12-month
Euro area*	1.19	1.19	1.22
Japan	113	106	98.0
Australia	1.43	1.39	1.35
Britain†	1.78	1.79	1.82
Canada	1.39	1.35	1.32
Denmark	6.24	6.22	6.10
Sweden	7.69	7.66	7.20
Switzerland	1.29	1.28	1.23
China	8.28	7.95	7.60
Singapore	1.72	1.66	1.60
South Korea	1180	1105	1100
Brazil	3.14	2.92	3.10
Mexico	11.6	11.7	11.6
Poland	4.00	3.90	3.70
Russia	29.1	28.7	28.0
South Africa	6.85	7.15	7.20

*$ per € †$ per £

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Overview

May 13th 2004
From The Economist print edition

Fears of higher global interest rates caused J.P. Morgan's EMBI+ index of emerging-market debt to fall by 3.9% in the week to May 12th. **Turkish** and **Brazilian** debt was hit especially hard. However, both economies have been showing signs of improvement. Industrial production in the year to March rose by 14.9% in Turkey, and by 11.9% in Brazil.

India's industrial production rose by 6.7% in the year to March.

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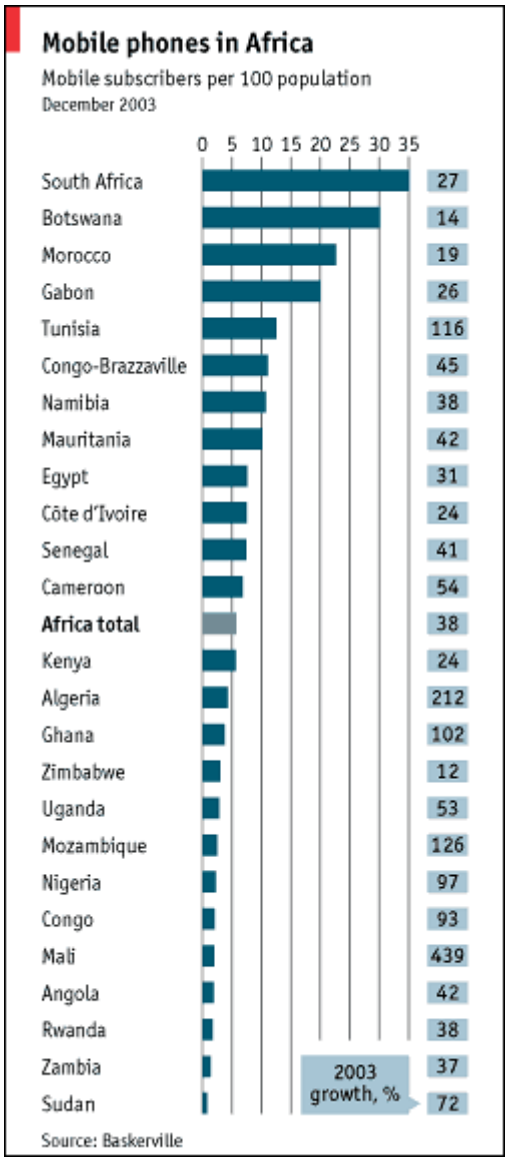
Mobile phones in Africa

May 13th 2004
From The Economist print edition

Africa's future is wireless. The number of mobile-phone subscribers increased by 38% during 2003 and is expected to grow by 52% this year, according to new figures from Baskerville, a consultancy. But growth is from a very low base: overall mobile-phone penetration is less than 6%. Nevertheless, mobile phones already outnumber fixed phones by two to one. They are used in innovative ways: for banking in Nigeria and to deliver election results in Kenya. Growth is being driven by policy reforms, strong demand and investments by regional firms such as Vodacom, MTN and Celtel.



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Economy

May 13th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.7	Q1	+19.1	Apr	+ 3.0	Mar	+14.7	Apr	+45.9	2003	439.8	Mar
Hong Kong	+ 5.0	Q4	– 6.1	Q4	– 2.1	Mar	–10.3	Mar	+17.4	Q4	123.8	Mar
India	+10.4	Q4	+ 6.7	Mar	+ 3.5	Mar	–15.4	Mar	+ 3.2	Q4	113.0	Apr
Indonesia	+ 4.4	Q4	+ 5.1	Jan	+ 5.9	Apr	+28.3	Mar	+ 7.8	Q3	36.1	Mar
Malaysia	+ 6.4	Q4	+13.2	Mar	+ 1.0	Mar	+20.6	Mar	+12.3	Q4	50.4	Mar
Philippines	+ 4.5	Q4	nil	Feb	+ 4.1	Apr	– 1.8	Feb	+ 3.3	Dec	13.4	Apr
Singapore	+ 7.3	Q1	+ 2.0	Mar	+ 1.3	Mar	+15.7	Mar	+28.2	Q4	102.7	Mar
South Korea	+ 3.9	Q4	+11.6	Mar	+ 3.3	Apr	+25.1	Apr	+20.4	Mar	163.6	Mar
Taiwan	+ 5.2	Q4	+15.7	Mar	+ 0.9	Apr	+15.2	Apr	+28.6	Q4	227.7	Apr
Thailand	+ 7.8	Q4	+ 7.9	Mar	+ 2.5	Apr	+ 3.4	Mar	+ 7.6	Mar	41.9	Mar
Argentina	+11.3	Q4	+12.4	Mar	+ 3.1	Apr	+14.2	Mar	+ 7.9	Q4	15.8	Apr
Brazil	– 0.1	Q4	+11.9	Mar	+ 5.3	Apr	+27.4	Apr	+ 5.7	Mar	51.6	Mar
Chile	+ 3.3	Q4	+ 7.8	Mar	– 0.3	Apr	+ 5.0	Apr	– 0.6	Q4	16.0	Mar
Colombia	+ 4.3	Q4	+ 6.1	Feb	+ 5.5	Apr	+ 0.2	Feb	– 1.4	Q4	11.3	Mar
Mexico	+ 2.0	Q4	+ 6.4	Mar	+ 4.2	Mar	– 6.0	Mar	– 9.2	Q4	61.6	Mar
Peru	+ 4.1	Feb	+ 2.2	Feb	+ 2.8	Apr	+ 1.3	Mar	– 1.1	Q4	9.7	Mar
Venezuela	+ 9.0	Q4	+33.4	Feb	+23.1	Apr	+15.0	Q4	+ 9.6	Q4	17.2	Feb
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.6	Feb
Israel	– 0.6	Q4	+ 8.8	Feb	– 2.7	Mar	– 5.4	Apr	– 0.2	Q4	27.0	Apr
South Africa	+ 1.5	Q4	– 1.4	Dec	+ 0.4	Mar	+ 2.0	Mar	– 1.5	Q4	8.6	Apr
Turkey	+ 6.1	Q4	+14.9	Mar	+10.2	Apr	–23.7	Feb	– 8.1	Feb	32.9	Mar
Czech Republic	+ 3.1	Q4	+15.3	Mar	+ 2.3	Apr	– 2.4	Mar	– 5.7	Q4	26.1	Apr
Hungary	+ 3.6	Q4	+12.8	Mar	+ 6.9	Apr	– 3.9	Mar	– 6.5	Mar	10.0	Apr
Poland	+ 4.7	Q4	+23.8	Mar	+ 1.7	Mar	– 5.3	Feb	– 3.7	Feb	35.3	Mar
Russia	+ 8.0	Q1	+ 6.6	Mar	+10.3	Apr	+63.3	Mar	+35.3	Q1	78.9	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.7	Q4	+ 5.2	Mar	+ 1.3	Apr	– 2.0	Mar	– 1.2	Q1	1.3	Mar
Latvia	+ 7.4	Q4	+14.8	Mar	+ 5.0	Apr	– 2.1	Feb	– 1.0	Feb	1.4	Mar
Lithuania	+ 7.5	Q1	na		– 0.6	Apr	– 2.8	Mar	– 1.2	Q4	3.4	Mar
Slovakia	+ 4.7	Q4	+ 9.6	Mar	+ 8.0	Apr	– 0.5	Mar	nil	Feb	11.7	Mar
Slovenia	+ 2.5	Q4	+ 7.8	Mar	+ 3.5	Apr	– 0.8	Mar	nil	Feb	8.6	Feb
Pakistan	+ 5.1	2003†	–13.3	Dec	+ 6.0	Apr	– 1.9	Apr	+ 3.6	Q4	11.5	Mar
Saudi Arabia	+ 6.4	2003	na		+ 0.4	Feb	+42.6	2002	+11.9	2002	21.6	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

May 13th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 12th		Dec 31st 2003	
	May 12th	year ago	May 12th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.7	4.38	1,682.2	+0.5	+ 7.2	+ 7.2
Hong Kong	7.80	7.80	13.8	0.56	11,528.2	– 3.5	– 8.3	– 8.8
India	45.4	47.1	80.5	4.41	5,358.4	– 5.8	– 8.2	– 7.7
Indonesia	8,950	5,450	15,888	7.51	744.3	– 1.8	+ 7.6	+ 1.2
Malaysia	3.80	3.80	6.75	2.99	818.7	– 3.3	+ 3.1	+ 3.1
Philippines	55.8	52.0	99.1	7.81	1,541.0	– 1.4	+ 6.8	+ 6.2
Singapore	1.72	1.73	3.05	0.81	1,802.2	– 4.1	+ 2.1	+ 0.8
South Korea	1,182	1,198	2,098	3.90	817.1	– 5.8	+ 0.8	+ 1.6
Taiwan	33.4	34.7	59.3	1.10	5,958.8	+1.8	+ 1.2	+ 2.8
Thailand	40.6	42.1	72.1	1.28	622.0	– 3.4	– 19.4	– 21.4
Argentina	2.92	2.77	5.18	3.13	940.4	–13.2	– 12.3	– 11.8
Brazil	3.11	2.89	5.53	15.77	18,388.1	– 8.2	– 17.3	– 23.4
Chile	641	697	1,137	1.68	7,211.6	– 1.7	– 1.7	– 9.1
Colombia	2,732	2,817	4,849	7.89	2,897.9	–13.3	+ 24.2	+ 26.4
Mexico	11.6	10.2	20.6	6.94	9,690.7	– 4.2	+ 10.2	+ 6.6
Peru	3.49	3.48	6.19	2.41	2,673.4	– 7.7	+ 9.8	+ 9.1
Venezuela	3,060§	1,598	5,432	12.99	24,882.7	– 4.0	+ 12.1	+ 4.4
Egypt	6.19	5.96	10.98	10.57	15,028.5	– 5.4	+ 29.1	+ 28.7
Israel	4.62	4.48	8.20	1.00	559.5	– 3.1	+ 4.7	– 0.4
South Africa	6.88	7.60	12.2	8.20	10,016.4	– 5.3	– 3.6	– 6.5
Turkey	1,540,450	1,486,000	2,734,607	25.23**	17,144.7	– 6.2	– 7.9	– 16.0
Czech Republic	27.0	27.4	47.9	2.14	763.4	– 3.9	+ 15.8	+ 10.3
Hungary	213	213	379	11.48	10,562.3	– 5.3	+ 12.6	+ 9.4
Poland	4.02	3.77	7.13	6.01	22,870.3	– 5.2	+ 9.8	+ 2.3
Russia	29.1	31.0	51.6	14.00	589.6‡	– 7.4	+ 3.4	+ 3.9
EMF (MSCI)*	1.00	1.00	1.78	na	421.9	– 5.4	– 4.7	– 4.7
EMBI+†	1.00	1.00	1.78	na	272.9	– 3.9	– 7.4	– 7.4

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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